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**Farm and factory: An analysis of the distinctions between and fiscal treatment of taxpayers simultaneously carrying on farming operations and manufacturing processes under the Income Tax Act No. 58 of 1962**

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## DECLARATION

I, August Charles Rudolf Katzke, hereby declare that the work on which this dissertation is based is my original work (except where acknowledgments indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university.

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## **ABSTRACT**

The Income Tax Act No. 58 of 1962 contains favourable concessions applicable to taxpayers who derive income from the carrying on of farming operations. Taxpayers who carry on processes of manufacture may also expect favourable fiscal treatment, albeit to a lesser extent. The most relevant concessions applicable to the aforementioned distinct classes of taxpayers are discussed, and where applicable, reference is made to judicial commentaries and the literature as regards potential interpretational difficulties. Accordingly, it is submitted that the first mentioned class of taxpayers above receive more extensive concessions with more favourable results than the latter.

It is argued that the phrase 'farming operations' has been interpreted by the Courts and commentators to include, in certain circumstances, activities which go beyond the meaning ordinarily attributed to this phrase, such as the distribution of farming produce. Relevant cases are discussed and principles which have arisen therefrom are identified. Subsequently, cases are discussed which support the submission that the phrase 'farming operations' may include 'processes of manufacture' within its ambit, under certain circumstances.

Ultimately, with the aid of a hypothetical scenario, it is submitted that taxpayers who can formulate a convincing argument for such widening of the scope of 'farming operations', so as to include their process of manufacture therein, may potentially apply the more favourable farming concessions to such manufacturing processes.

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Rudi Katzke

Cape Town, August 2009

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# 1. INTRODUCTION

## 1.1. BACKGROUND

It is well known that the South African income tax regime offers favourable treatment for taxpayers carrying on certain types of activities. From the perspective of the *fiscus*, such favourable treatment may lead to a smaller intake of revenue, but in some instances public policy and economic considerations outweigh the concerns and a favourable taxation regime is justifiable. If one considers two of the most classic examples of favourable fiscal regimes, namely those pertaining to farming operations and manufacturing processes, certain public policy benefits may be identified.

South Africa has a rich heritage as an agricultural producer. From the Cape's acclaimed wine farms dating back to the earliest settlers of the southern tip of Africa, to the cultivation of sugar cane in Kwazulu-Natal, farming in its various forms is a thriving and cardinal industry. Not only does the agricultural industry serve as one of the economic foundations of our country, it is an essential provider of employment and livelihood to many South Africans, contributing approximately 3.4% to South Africa's gross domestic product and employing about 9% of the country's workforce.<sup>1</sup>

The manufacturing sector is similarly a very important industry for South Africa's economic wellbeing and future welfare, ranging from automotive assembly to the textile, food and chemical industries.<sup>2</sup> The latest statistical data indicate that petroleum, chemical products, rubber and plastic products are the most significant contributors to the total income of the manufacturing industry.<sup>3</sup> The chemical industry alone contributes approximately 5% of South Africa's gross domestic product, and about 25% of the country's manufacturing sales.<sup>4</sup>

In light of the above, it is evident that the agricultural and manufacturing sectors are crucial contributors to the South African economy. The benefits of favouring and promoting these industries are thus self-apparent. While there are many methods of doing so, one of the

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<sup>1</sup> 'South Africa' (Last update: 12 May 2009) *Central Intelligence Agency – World Factbook*, Available at <https://www.cia.gov/library/publications/the-world-factbook/geos/SF.html>.

<sup>2</sup> Ibid.

<sup>3</sup> 'P3002 - Manufacturing Industry, 2005' (Published 5 October 2006) *Statistics South Africa*, Key findings available at <http://www.statssa.gov.za/publications/statskeyfindings.asp?PPN=P3002&SCH=3760>.

<sup>4</sup> 'Manufacturing in South Africa' *www.SouthAfrica.info* (Accessed 23 June 2009) Available at <http://www.southafrica.info/business/economy/sectors/manufacturing.htm>.



most effective and direct methods of advancing an industry is through a preferential fiscal regime. The Income Tax Act No. 58 of 1962 ('the Act')<sup>5</sup> thus contains various provisions designed to act as incentives to taxpayers carrying on such operations. Farmers in particular are often referred to as a 'privileged class' due to the favourable fiscal treatment enjoyed by them.

## 1.2. OBJECTIVES AND APPROACH

This study firstly considers the distinctions between the fiscal treatment of taxpayers who either carry on farming operations or manufacturing processes. The relevant legislative provisions will be referred to and discussed, but only to the extent as required by the ambit of this study.

The main focus is, however, on taxpayers who carry on the abovementioned activities *simultaneously*. As will be shown, such taxpayers may face anomalous and uncertain scenarios. A major potential problem for them is to identify what tax treatment should apply to their operations, and to what extent. Put differently, the question may arise as to what extent taxpayers' operations may more properly be described as farming operations (thus potentially qualifying for the tax treatment applicable to farmers), or as a process of manufacture, thus qualifying for the (generally) less favourable tax treatment applicable to such operations.

The need for clarity in this regard becomes especially pressing when one of the potentially applicable tax regimes leads to more favourable results than the other. This study thus aims to investigate whether and to what extent such clarity may be obtained, and to consider the potential benefits to taxpayers. In order to achieve this goal, the methodology to be applied is the interpretational rules applicable to fiscal legislation as supported by judicial commentaries and clarification of extraneous issues from the literature.

Instances will be considered where taxpayers' manufacturing processes were found to be unrelated to their farming operations, leading to judgments adverse to their claims. The study also considers those instances where taxpayers' manufacturing processes were found to be indivisible from or causally linked to their farming operations. The resulting

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<sup>5</sup> This study takes into account all relevant tax legislative amendments up to and including the amendments brought about by the Revenue Laws Amendment Act No. 60 of 2008. All references to 'section' and 'paragraph' are to sections of the Act and paragraphs of the First Schedule thereto, unless specifically indicated otherwise.

judgments were favourable to such taxpayers. The relevant factual circumstances will be closely examined in considering all of the cases referred to.

While all of the judgments which are referred to were unquestionably dependent on the specific circumstances of each taxpayer at hand, it is submitted that various general principles may nonetheless be harvested from these sources. While not attempting to provide a universal solution or simple checklist, the ultimate goal of this study is thus to identify and discuss such general principles as may arise from the case law and commentaries referred to.

To the extent that the necessary factual circumstances are in place, such general principles may ultimately be applied by taxpayers who carry on farming operations and manufacturing processes simultaneously. It is hoped that this, in turn, may assist taxpayers to obtain the most favourable fiscal treatment available to them, which is likely to have economically and socially beneficial effects for our society.

## 2. FARMING - LEGISLATIVE CONTEXT

### 2.1. INTRODUCTION

Many South African farmers today face external factors which may present opportunities, but also pose serious challenges, including *inter alia* land distribution, black economic empowerment, restrictive labour policies and other economic issues.<sup>6</sup> Such challenges may increase the costs to farmers of doing business, and may ultimately even affect their competitiveness, but fortunately there are many viable strategies and institutional innovations which may assist farmers in overcoming such challenges.<sup>7</sup> This study proposes that a further important strategy to assist farmers in overcoming economic and other external challenges comes in the form of fiscal stimuli. This chapter aims to investigate the relevant provisions in the Act which favour farmers as a class.

The initial focal point when considering the taxation regime applicable to farmers (or more accurately, taxpayers who carry on farming operations), is section 26,<sup>8</sup> seeing as ‘farming’ is not specifically mentioned as a ‘trade’ in the definition of the latter term in section 1.<sup>9</sup> The heading of this section declares that it deals with the ‘Determination of taxable income derived from farming’. Section 26(1) reads as follows:

‘(1) The taxable income of any person *carrying on pastoral, agricultural or other farming operations* shall, in so far as it is *derived from such operations*, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule.’ [Emphasis added.]

Firstly, it appears from the above that the benefits of the First Schedule<sup>10</sup> can only apply to a particular taxpayer if he derives income from ‘pastoral, agricultural or other farming operations’. Losses are not mentioned specifically in section 26, but it is understood that the First Schedule may also be applicable, even if a loss arises from the ‘pastoral, agricultural or other farming operations’, instead of taxable income.<sup>11</sup> The scope of this

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<sup>6</sup> G F Ortmann *Promoting the competitiveness of SA Agriculture in a dynamic economic and political environment* (2005), 291.

<sup>7</sup> Ibid, 297.

<sup>8</sup> Note that the ambit of this study does not extend to the fiscal concessions available specifically to agricultural co-operatives, as dealt with in sections 27 and 12C(1), seeing as they represent too narrow a class of taxpayer.

<sup>9</sup> M C J Bobbert *Wat is die betekenis van boerdery vir Inkomstebelastingdoeleindes?* (2001) 32.

<sup>10</sup> The most notable provision of the First Schedule for purposes of this study is the deductibility of so-called capital development expenditure in terms of paragraph 12(1). Refer to 2.3.2 below.

<sup>11</sup> A P De Koker *Silke on South African Income Tax* (2008) 15.4; and M Stiglingh et al *Silke: Suid-Afrikaanse Inkomstebelasting* (2009) 592.

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study does not extend to a consideration of the tax consequences of losses arising from farming operations.

Section 26(2), in turn, deals with persons who have ceased with 'carrying on pastoral, agricultural or other farming operations', and determines that the provisions of the Act (subject to certain paragraphs of the First Schedule) may continue to apply to such persons for a certain period. As will become clear, the ambit of this study is limited to taxpayers *carrying on* such operations and does not extend to those who have ceased to do so. Section 26(2) thus requires no further consideration for purposes of this study.

Taxpayers to whom the provisions of section 26(1) apply are still in general subject to the provisions of the Act as a whole, but with the specific benefits and other provisions of the First Schedule applicable to them, where relevant. In this regard it has been noted that 'income from farming operations is determined separately but is not taxed separately, and forms part of the taxpayer's overall taxable income.'<sup>12</sup> Therefore, in order to accurately determine what income is derived from 'pastoral, agricultural or farming operations', it is important that the terms used in section 26(1) be interpreted correctly.

A number of key terms used in section 26(1) are not defined in the Act. Moreover, it is important to note that there are certain inconsistencies in the terminology of the Act, e.g. in some instances reference is made to taxpayers carrying on 'farming operations', but elsewhere simply to 'farmers'.<sup>13</sup> There is thus a need for clarity as to the correct interpretation of the phrases used in section 26(1), and their relationship with the provisions of the rest of the Act. Fortunately, there are various instances of local and foreign case law and commentary where the terms used in section 26(1) of the Act (and similarly worded provisions in fiscal statutes of other jurisdictions) were considered. In what follows, the most relevant of these terms and phrases are considered individually.

In particular, it will be shown that the phrases 'carrying on', 'pastoral' and 'agricultural', 'other farming operations' and 'income derived from such operations' have given rise to some difficulties in interpretation. The aim of the following sections (2.2.1 – 2.2.4) is to address these interpretational issues with reference to case law and commentary.

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<sup>12</sup> R C Williams *Income Tax in South Africa – Law and Practice* (2006) 738, with reference to ITC 926 24 SATC 254 at 258.

<sup>13</sup> Ibid, 738; for instance, the phrase 'farmer' is used in the preamble to paragraph 12(1) of the First Schedule, a very important paragraph which will be considered in this study (at 2.3.2 – 2.3.3).

## 2.2. INTERPRETATION OF SECTION 26

### 2.2.1. 'CARRYING ON'

The phrase 'carrying on' has not been defined in the Act, but may be described in general terms as to 'continue an activity or task.'<sup>14</sup> This particular phrase, while seemingly straightforward in meaning, has been the subject of much judicial consideration. It has been noted that while generalisations are perilous, certain general guidelines may nonetheless be set out against which economic activities may be tested to determine whether they qualify as 'pastoral, agricultural or other farming operations'.<sup>15</sup> The latter term is one of the focus areas of this study.

A protracted debate in judicial precedents flowed from the above requirement for a factual review of the taxpayer's circumstances. This debate basically involved two distinct schools of thought. On the one hand, there was the view that the factual criterion is entirely subjective, i.e. an enquiry was required into whether the taxpayer intended in good faith to engage in farming operations. An example of a preference for this subjective enquiry is *ITC 1424*,<sup>16</sup> where the taxpayer's loss-making farming activities were regarded by the revenue authorities to be a mere 'hobby' and thus not qualifying for the favourable fiscal dispensation for farmers, whereas the Court found otherwise. While the Court agreed that farming concessions should not apply to taxpayers who 'indulge in certain country pursuits merely as an interest, or to give themselves a more enjoyable way of life,'<sup>17</sup> (i.e. so-called 'hobby farmers'),<sup>18</sup> it found on the facts that this description did not apply to the taxpayer. Instead, the Court found that the taxpayer was 'travelling hopefully' in carrying on his unsuccessful farming operations, that this hope was based on a reasonable foundation, and that the taxpayer's operations did indeed constitute the carrying on of a trade as a farmer.<sup>19</sup>

The opposing view in the abovementioned debate was that an objective element is also required (i.e. that, coupled with the subjective element, the external factors must indicate that the taxpayer's activities constitute farming operations). In this regard it has been held that the question of whether or not a person may be regarded as carrying on 'pastoral,

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<sup>14</sup> C Soanes & A Stevenson *The Oxford Dictionary of English* (2005), 265.

<sup>15</sup> Bobbert (note 9 above) 34.

<sup>16</sup> (1986) 49 SATC 99 (Z). This was a decision by the Zimbabwe Special Court, and thus not binding in South African law, but it is submitted that it may still be relevant for guidance purposes as it dealt with similarly worded legislative provisions.

<sup>17</sup> *Ibid*, 104.

<sup>18</sup> *Williams* (note 12 above) 744.

<sup>19</sup> *ITC 1424* (note 16 above) 107.

agricultural or other farming operations' is one of fact determined with reference to the circumstances of the particular case.<sup>20</sup> In other words, careful consideration must be given in each particular case to the factual circumstances of a taxpayer in order to decide whether section 26 will apply to his / her activities.<sup>21</sup>

In a decision effectively ending the above debate as to which approach is correct, that of *C:SARS v Smith*, the Supreme Court of Appeal held that the test as to whether a taxpayer is carrying on farming operations in terms of section 26 is an entirely subjective one.<sup>22</sup> It was held further that section 26(1) does not provide any discernible reason for introducing 'a reasonable prospect of profit' as a separate requirement to the taxpayer's genuine intention to make a profit.<sup>23</sup> In conclusion it was held that a taxpayer who wishes to rely on section 26(1) must show proof that he is engaged in an activity in the nature of farming, and that he 'possesses at the relevant time a genuine intention to carry on farming operations profitably.'<sup>24</sup> Such a taxpayer will thus have established that he is indeed engaged in farming operations and may have access to the relevant favourable legislative provisions, whereas the converse will apply if he fails to meet the tests in *Smith's* case.<sup>25</sup>

Importantly, it must be noted that *Smith's* case does not completely do away with the query as to whether a taxpayer's farming operations had an objectively reasonable prospect of profitability. This question remains relevant, but only in so far as it sheds light on the credibility of the taxpayer's claimed intention of carrying on farming operations profitably.<sup>26</sup> The legislative position as it stands after *Smith's* watershed case has been usefully summarised as follows:

'Accordingly a taxpayer who relies on s26(1) is (over and above proof that he is engaged in an activity in the nature of farming) only required to show that he possesses at the relevant time a genuine intention to carry on farming operations profitably and all considerations which bear on that question including the prospect of making a profit will contribute to the answer, none of itself being decisive.'<sup>27</sup>

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<sup>20</sup> *ITC 1319 42 SATC 263 (EC) 264; ITC 1414 48 SATC 174 (T) 178.*

<sup>21</sup> *Ibid*, 263.

<sup>22</sup> *C:SARS v Smith* 2002 (6) SA 621 (SCA), 65 SATC 6; L Olivier *Law of Taxation* (2003) 921 and Williams *Law and Practice* (note 12 above) 741.

<sup>23</sup> *Ibid*, 13.

<sup>24</sup> *Ibid*.

<sup>25</sup> Williams *Law and Practice* (note 12 above) 742.

<sup>26</sup> R C Williams *Income Tax in South Africa – Cases and Materials* (2005) 551, with reference to *C:SARS v Smith* (note 22 above).

<sup>27</sup> R Stretch & J Silke *SCA Rules on meaning of 'farming operations' and jettisons the 'reasonable prospect of profit' requirement* (March 2003).

In reaction to the abovementioned decision in Smith's case,<sup>28</sup> the legislature enacted section 20A, which ring-fences the losses arising from certain 'suspect trades' (i.e. certain trades which do not have a reasonable prospect of turning a profit within a reasonable time). 'Farming or animal breeding' which is not carried on on a full-time basis, is specifically included as a 'suspect trade'.<sup>29</sup> Williams notes that losses incurred by a taxpayer in carrying on farming operations (i.e. having passed the subjective test laid down in Smith's case) may be subject to the provisions of section 20A, but emphasises that this section has not nullified the decision in Smith's case.<sup>30</sup> While the aforementioned comments are relevant for background purposes, section 20A falls outside of the ambit of this study and will not be considered in further detail. This is due to the fact that section 20A deals specifically with assessed losses, whereas the focus of this study is rather on taxable income earned from farming operations and manufacturing processes, and the applicable fiscal concessions available in those respects.

It has further been held that it is not a prerequisite that operations be carried on on an extensive area or scale to be recognised as farming operations,<sup>31</sup> and also that a person may carry on various trades with 'farming' being merely one of them.<sup>32</sup> Ultimately, though, the question as to whether a taxpayer's activities constitute the carrying on of farming operations is a question of fact.<sup>33</sup> Considerations such as the area or scale of a taxpayer's operations, or other trades carried on by him, are merely further considerations which bear on the question as to whether the taxpayer genuinely intends to carry on farming operations.

#### 2.2.2. 'PASTORAL' AND 'AGRICULTURAL'

The terms 'pastoral' and 'agricultural' are of a specific character, whereas the subsequent phrase in section 26(1), 'or other farming operations' (discussed in 2.2.3), is of a general nature. The terms 'pastoral' and 'agricultural' are not defined in the Act, and regard may thus be had, as a starting point, to general dictionary definitions. The term 'pastoral' may

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<sup>28</sup> Olivier (note 22 above) 921.

<sup>29</sup> Section 20A(2)(b)(vi).

<sup>30</sup> Williams *Law and Practice* (note 12 above) 742.

<sup>31</sup> R C Williams *The Law of South Africa* 534, with reference to ITC 208 6 SATC 55, ITC 937 24 SATC 374.

<sup>32</sup> Ibid, with reference to ITC 639 15 SATC 226; Williams *Cases and Materials* (note 26 above) 535, and *Buglers Post (Pty) Ltd v SIR* (note 74 below).

<sup>33</sup> *CIR v D&N Promotions (Pty) Ltd* (1995) 57 SATC 178 at 183.



be defined as '(land) used for the keeping or grazing of sheep or cattle.'<sup>34</sup> The word 'agriculture', of which the adjective 'agricultural' is derived, may in turn be defined as 'the science or practice of farming, including cultivation of the soil for the growing of crops and the rearing of animals to provide food, wool, and other products.'<sup>35</sup> The interaction between the former specific terms and the latter general phrase, as well as the relevant principle of statutory interpretation, will be considered in greater detail below.

The Afrikaans translation of the abovementioned terms perhaps provides further clarity as to their intended meaning, namely 'veeboerdery' (which may be loosely translated as 'livestock farming', in the case of 'pastoral' operations), as opposed to 'landbou' (which is accurately translated as 'agriculture' in section 26(1)).

In considering the meaning of the terms 'pastoral' and 'agricultural' in a Zimbabwean income tax provision similarly worded to section 26(1), the Court noted that such activities normally constitute the production of stock and produce from a land-based economy.<sup>36</sup>

It is submitted that income derived by a taxpayer from the carrying on of operations which are manifestly of a 'pastoral' or 'agricultural' nature, i.e. involving the production of livestock or produce from a land-based economy, should be subject to the provisions of section 26(1) (and, by implication, the provisions of the First Schedule). In addition, in applying the subjective approach favoured by the Supreme Court of Appeal,<sup>37</sup> a taxpayer who carries on the abovementioned operations without a reasonable prospect of profit may nonetheless be able to rely on the provisions of section 26.

The discussion below considers the meaning of the phrase 'other farming operations'.

### 2.2.3. 'OTHER FARMING OPERATIONS'

The following lucid *dicta* from *ITC 1373* deserve to be quoted in full, where it was held that by using the words 'other farming activities' in a similar legislative context,<sup>38</sup>

'... the legislature intended to widen the ambit of activities that were included ... beyond those that were strictly pastoral or agricultural. If the intention had been to limit the scope of the relief to those

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<sup>34</sup> *The Oxford Dictionary* (note 14 above) 1287.

<sup>35</sup> *Ibid*, 32.

<sup>36</sup> *ITC 1373* 45 SATC 189 (Z) 194, and refer to note 38 below.

<sup>37</sup> *C:SARS v Smith* (note 22 above).

<sup>38</sup> As mentioned above, this case was based on the Zimbabwean income tax legislation, which contained, in its definition of a 'farmer', taxpayers who derive income from 'pastoral, agricultural or other farming activities', which phrase is identical to that contained in section 26(1), save for the substitution of the word 'operations' for 'activities'.

taxpayers whose activities fell only within the ambit of those words, there would have been no need for the next phrase because those two explicit categories would have exhaustively described all the recipients of the fiscal policy assistance to farmers.’<sup>39</sup>

The President of the Court, Squires J, then went on to juxtapose the above remarks with the following comments:

‘On the other hand ... the general words ‘other farming activities’ take their colour and tenor from the preceding particular words, and the activities thereby contemplated must be activities that are farming in the same sense that pastoral and agricultural activities are farming ... the legislature must have intended to so narrow the scope of activities that otherwise would be included in the word ‘farming’, because without such limitation it could arguably include a variety of other pursuits that are not concerned with the primary production of stock and produce from a land-based economy, but which could be called farming.’<sup>40</sup>

In the abovementioned case, the Court found that the raising of thoroughbred horses by a taxpayer fell within the ambit of the general phrase ‘other farming activity’, alternatively that this was a ‘pastoral’ activity as it involved the care of a herd. The income derived by the taxpayer in this case from these activities was thus found to qualify for the applicable relief offered to farmers.<sup>41</sup>

The above approach of the Court is consistent with the canon of interpretation referred to as the *ejusdem generis* rule (meaning ‘of the same kind’), which holds that ‘... a general provision is to be read subject to special provisions in the same document.’<sup>42</sup> The following description of the application of the *ejusdem generis* rule is especially relevant for present purposes, and is borne out by the approach of the Court referred to above:

‘Where words (which) have a particular meaning or limited meaning, are followed by a phrase of general application, the meaning of the said general phrase is restricted to the generic meaning of the preceding words.’<sup>43</sup>

It is thus submitted that the phrase ‘or other farming operations’, when preceded (as in section 26(1)) by the words ‘pastoral’ and ‘agricultural’, indicates ‘the use of land either for growing marketable crops or for using the products of the land for the rearing or feeding of animals and other stock.’<sup>44</sup> However, it may rightly be said that modern

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<sup>39</sup> *ITC 1373* (note 36 above) 193.

<sup>40</sup> *Ibid*, 194.

<sup>41</sup> *Ibid*, 196.

<sup>42</sup> E A Kellaway *Principles of Legal Interpretation – Statutes, Contracts & Wills* (1995) 147, with reference to Van den Berg 3 c 98 225; *Utrechtse Consultatien* 1 c 23 n8.

<sup>43</sup> *Ibid*, 148, with reference to Du Plessis *The Interpretation of Statutes* (1986) 154.

<sup>44</sup> D Meyerowitz *The Taxpayer’s Tax Library – Electronic Meyerowitz* (2007-2008) 20.5.

production methods preclude such a limited meaning of 'other farming operations'.<sup>45</sup> One may, for instance, consider the production of eggs by using the battery system, where chickens are fed by mechanical means and do not 'live off the land', or dairy farming, where most of the fodder may be purchased by the owner instead of grown on his own land. These examples have been held to constitute 'farming operations',<sup>46</sup> even though they indicate a wider ambit than the preceding words to 'other farming operations' may indicate.

In light of the considerations above, it is submitted that the phrase 'carrying on pastoral, agricultural or other farming operations' in section 26(1) may include a wide range of 'farming' activities. However, it should be noted that this range of activities is not so wide as to include activities which are manifestly not farming operations, such as speculation with livestock, for example. It has been held that a speculator in livestock 'is really concerned with the marketing of animals, he does not usually retain those animals for a long time ... (and) does not do anything to improve the quality of those animals',<sup>47</sup> whereas a farmer's operations are essentially different to speculation, namely 'to acquire a particular asset, to work on that asset and through farming methods to realise it at a profit.'<sup>48</sup> It appears further that the South African Revenue Service ('SARS') also regards livestock speculation as a business distinct from farming operations.<sup>49</sup>

It is thus submitted that care should be taken in seeking to argue that the activities of a taxpayer constitute 'pastoral, agricultural or other farming operations'. The first two terms are specific and have a clearer meaning, while the latter phrase has a wider ambit and is more open to interpretation. As noted above, the phrase 'other farming operations' must thus be construed in light of the specific preceding terms.

The taxable income of a person who carries on operations which fit into the ambit of either 'pastoral', 'agricultural' or 'other farming operations', and who possesses a genuine intention to carry on such operations, should thus qualify for the treatment envisaged in section 26(1), provided that his income is 'derived from such operations.' This latter relevant phrase of section 26(1) is considered in more detail below.

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<sup>45</sup> *Meyerowitz* (note 44 above) 20.5.

<sup>46</sup> *Ibid*, citing *Reid v IRC* (1947) 28 TC 451.

<sup>47</sup> *ITC 586 14 SATC 123 (U) 125*.

<sup>48</sup> *Ibid*.

<sup>49</sup> *Williams Law and Practice* (note 12 above) 744.

#### 2.2.4. 'INCOME DERIVED FROM SUCH OPERATIONS'

This phrase indicates the requirement of a causal connection between income and the 'pastoral, agricultural or other farming operations' of a taxpayer in order for such income to be 'derived from' such operations. It is understood that the word 'derived' should be treated as synonymous with the words 'arising' or 'accruing', thus implying a direct causal connection.<sup>50</sup>

In this regard, the Appellate Division (as it then was), in the case of *D&N Promotions*,<sup>51</sup> agreed with the following *dicta* from *ITC 1319*,<sup>52</sup> namely that:

'... the income and the source from which the income arises, namely farming operations, which of course embraces numerous agricultural activities, must be directly connected. An indirect or remote one will not suffice.'

The Appellate decision in *D&N Promotions* upheld the judgment of the court *a quo* (delivered by the Natal Special Court in *ITC 1505*),<sup>53</sup> in a clear example of the application of the latter principle requiring a direct connection between income and farming operations. In the court *a quo* it was found that interest accruing to the appellant (a sugar cane grower) formed part of the compensation for the product produced by him in the course of his farming operations, and thus fell to be dealt with in terms of section 26(1) and the provisions of the First Schedule.<sup>54</sup> However, a further amount of interest from invested surplus funds, due to the appellant, was found by the Court not to be derived from farming operations.<sup>55</sup>

It is further not enough to simply show that the income was derived from the produce of the land in question; it must be the result of a farming operation – for example, rental income from the leasing of farming land is not derived from farming operations but rather from the ownership of the land.<sup>56</sup>

On the other hand, where a taxpayer leases his farmland to another in return for a share of the produce from the land, or a share of the proceeds of such produce (a so-called

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<sup>50</sup> De Koker *Silke* (note 11 above) 15.32, quoted with approval in *ITC 1505* (note 53 below) 415.

<sup>51</sup> *CIR v D&N Promotions* (note 33 above) 183.

<sup>52</sup> Note 20 above.

<sup>53</sup> *ITC 1505* 53 SATC 406 (N).

<sup>54</sup> *Ibid*, 416.

<sup>55</sup> *Ibid*, 418.

<sup>56</sup> *The Law of South Africa* (note 31 above) 534, with reference to *ITC 166* 5 SATC 85; *ITC 732* 18 SATC 108; and *ITC 1285* 41 SATC 73.

‘partiarian’ lease),<sup>57</sup> then the necessary direct connection between such consideration and the farming operations should be established, and the consideration will be ‘income from farming operations.’<sup>58</sup>

These examples emphasise the importance of the factual circumstances of the taxpayer, to determine whether income earned by him is ‘*derived from* pastoral, agricultural or other farming operations’ in terms of section 26(1). Put differently, this is a question of fact and not one of law, and it arises because of the requirements laid down by section 26(1) and the First Schedule, which must be satisfied before the benefits of the relevant provisions may be available to a taxpayer.<sup>59</sup>

In addition to the comments above, section 17A deserves brief mention. This section allows the deduction of expenditure incurred on soil erosion works from the income derived by a taxpayer (the lessor) from letting land on which *bona fide* pastoral, agricultural or other farming operations were carried on (as long as the lessor can produce a specified certificate).<sup>60</sup> Thus, while such rental income derived by the lessor will simply form part of his taxable income, the lessor may benefit from the deduction allowed in section 17A of expenditure which is arguably of a capital nature, and would thus not ordinarily be allowed as a deduction under the general deduction formula.<sup>61</sup>

As pointed out above, however, the rental income referred to in section 17A is not income derived from ‘the carrying on of pastoral, agricultural or other farming operations’ of the lessor, as it is the lessee who is farming. While the deduction of expenditure on soil erosion works incurred by the lessor may thus be allowed in terms of section 17A, the rental income itself falls outside the ambit of section 26(1) and the First Schedule. Accordingly, section 17A bears no further consideration within the ambit of this study.

From the point of view of the lessee it should be noted, however, that income earned by him from the use of farmland may still constitute ‘income derived from farming operations,’ if the relevant factual circumstances are present. In this regard it has been held that a taxpayer need not be the owner of farmland in order to derive income from it – he

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<sup>57</sup> Williams *Law and Practice* (note 12 above) 739 regarding partiarian leases; with reference to *Oosthuizen v Estate Oosthuizen* 1903 TS 688 at 692; *Blumberg & Sulski v Brown and Freitas* 1922 TPD 130.

<sup>58</sup> ITC 166 5 SATC 85, 86 – 87; ITC 1630 60 SATC 59, 62; Williams *Law and Practice* (note 12 above) 739.

<sup>59</sup> R Stretch & J Silke *Farming Operations – Consideration Received for Hire of a Farm* (September 1999), with reference to ITC 1630 (note 58 above).

<sup>60</sup> Section 17A(1).

<sup>61</sup> Section 11(a) read with section 23(g); Williams *Law and Practice* (note 12 above) 754.

must merely have a right to the land and its produce.<sup>62</sup> This should be the case for a lessee who has the right to use farmland and the produce which it brings forth.

## 2.3. THE FIRST SCHEDULE

### 2.3.1. INTRODUCTION

As mentioned above, section 26 determines that the First Schedule applies in computing the taxable income derived by a taxpayer from ‘carrying on pastoral, agricultural or other farming operations.’<sup>63</sup> Nonetheless, certain tax benefits available to taxpayers who carry on such operations are found outside of the First Schedule, for instance in section 12B(1)(f), which allows such taxpayers a deduction in respect of *inter alia* machinery.<sup>64</sup>

Other sections specifically exclude ‘farming’ from their ambit, for instance section 12C(1)(a) and (b)<sup>65</sup> and section 22(1), which deals with trading stock. Such exclusions are not without reason, however, and are crucial for the operation of the First Schedule. Were it not for the specific exclusion of ‘farming’ from the ambit of section 22, for example, a farmer’s livestock and produce would also have been ‘trading stock’ for purposes of that section.<sup>66</sup> The reason for this exclusion is that the First Schedule contains specific provisions regarding the determination and treatment of the value of livestock and produce. Accordingly, a brief overview of the paragraphs of the First Schedule is set out below.

Paragraph 1 clarifies the frequent references to ‘year of assessment’ in the Schedule and allows varying periods of assessment in certain circumstances. In general, paragraphs 2 – 8 deal with the determination and treatment of the value of livestock in various circumstances, including the ring-fencing of losses arising therefrom. Paragraph 9 deals with the valuation of produce and paragraph 11 deals with recoupments in respect of livestock or produce in various instances. The provisions of paragraph 12 will be dealt with in detail below.

Paragraph 13 contains a special concession applicable to farmers who are forced to sell and replace (within specified periods) livestock due to *inter alia* drought or so-called livestock reduction schemes organised by the Government. Paragraph 13A applies to farmers who

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<sup>62</sup> *ITC 1548 55 SATC 26 (C) 29.*

<sup>63</sup> Section 26(1).

<sup>64</sup> Refer to the brief discussion of this section in 2.3.2 below.

<sup>65</sup> Section 12C is discussed in more detail under 3.2 below.

<sup>66</sup> *Williams Law and Practice* (note 12 above) 748.

are forced to dispose of livestock on account of drought and who deposit the resulting proceeds with the Land and Agricultural Bank of South Africa.

Paragraphs 14 – 16 contain special provisions applicable to plantation farmers, and paragraph 17 deals with sugar cane farmers whose crops are damaged by fire. Paragraph 19 determines that certain categories of farmers may elect to be taxed on their average farming income, in accordance with section 5(10).

Finally, paragraph 20 provides a special tax concession for farmers who cease their farming operations due to the acquisition of their income-producing farmland *inter alia* by the State, and who receive certain specified ‘abnormal farming receipts or accruals’.

There are various intricacies in applying the abovementioned paragraphs, none of which (aside from paragraph 12) fall within the ambit of this study. The broad overview above is largely for background purposes, but also to emphasise the point made by the Appellate Division that ‘farmers are, as a class, placed in a favourable position.’<sup>67</sup> Even though this comment was made with reference to an earlier (but similar) version of paragraph 12,<sup>68</sup> it is submitted that it accurately describes the fiscal treatment of taxpayers who derive income from farming operations as envisaged by section 26 and the First Schedule.

### 2.3.2. PARAGRAPH 12 – GENERAL

As noted above (at 2.1), taxpayers who carry on farming operations are also entitled to the deduction of expenses from taxable income in terms of the general deduction formula,<sup>69</sup> as section 26(1) subjects such taxpayers to the general provisions of the Act. Examples of deductible expenses which may be particular to farmers, but nonetheless deductible under the general deduction formula, include the purchase price of livestock, animal feed and fertilizer.<sup>70</sup> Farmers may also be entitled to the specific deductions allowed to other taxpayers in section 11 (for example repairs and maintenance in section 11(d)).

Paragraph 12, however, contains certain specific provisions which are solely aimed at ‘farmers’ (i.e. persons who carry on ‘pastoral, agricultural or other farming operations’ and derive income from such operations, as envisaged by section 26(1)). Most notably, paragraph 12(1)(a) - (i) lists a number of items of expenditure which are of a capital

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<sup>67</sup> *Ernst v CIR* [1954] 1 All SA 340 (A) 343.

<sup>68</sup> Paragraph 17 of the Third Schedule of the Income Tax Act No. 31 of 1941 (repealed).

<sup>69</sup> Note 61 above.

<sup>70</sup> De Koker *Silke* (note 11 above) 15.29.

nature, but may nonetheless be deductible by a farmer from his / her taxable income. It is apparent that this concession runs against the grain of the Act to an extent, as it generally does not allow the deduction of expenses of a capital nature from taxable income.<sup>71</sup> As will be discussed further below, this concession clearly places farmers in a privileged class.<sup>72</sup>

The types of expenses in paragraph 12(1)(c) - (i) are commonly referred to as 'capital development expenditure.'<sup>73</sup> The remarks of the Appellate Division in *Buglers Post*<sup>74</sup> regarding the legislative intention behind the concessions granted in section 26 and paragraph 12 of the First Schedule are perhaps a useful starting point in this regard. In the words of Rumpff ACJ:

'Having regard to s 26 of the Act and para 12 of Schedule 1, it seems clear that the intention of the legislature was to encourage a farmer to improve his farm so as to increase its productivity and to allow a farmer the deduction of expenses incurred in the improvement of his farm, such expenses to include the costs of certain capital works erected on his farm.'<sup>75</sup>

These comments were echoed by the Zimbabwe Special Court, which remarked that the concessions to farmers – especially the deduction of capital expenditure – were intended to 'give incentives to persons engaged in the trade of primary production as farmers to effect substantial improvements to land occupied by them.'<sup>76</sup>

Moreover, the Appellate Division in *Buglers Post* agreed with the remark in *Ernst v CIR*<sup>77</sup> that these concessions place farmers in a favourable position, and that there is no justification in the legislation for extending the exception (namely that farmers may deduct capital expenditure in terms of the relevant paragraph).<sup>78</sup> Accordingly, the types of expenditure listed in paragraph 12(1) must be strictly construed, based on the rule of interpretation that the Court has a duty to reject any extension of a class privilege of exemption from taxation.<sup>79</sup>

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<sup>71</sup> R Stretch & J Silke *SCA grapples with the true nature of an assessment* (July 1998), with reference to *Odendaal v KBI* (note 73 below).

<sup>72</sup> De Koker *Silke* (note 11 above) 15.30.

<sup>73</sup> *Odendaal v KBI* (1998) 2 All SA 461 (A) 464; Stiglingh *Silke* (note 11 above) 601; Williams *Law and Practice* (note 12 above) 755.

<sup>74</sup> *Buglers Post (Pty) Ltd v SIR* 1974 (3) SA 28 (A), 36 SATC 71.

<sup>75</sup> *Ibid*, 75.

<sup>76</sup> *ITC 1424* (note 16 above) 104.

<sup>77</sup> Note 67 above, 343.

<sup>78</sup> *Buglers Post* (note 74 above) 76.

<sup>79</sup> De Koker *Silke* (note 11 above) 15.30.



It has further been noted that it is only where ‘a *genuine* business of farming ... is carried on’ that the expenditure referred to in paragraph 12 may be admitted for deduction,<sup>80</sup> which provides evidence of the abovementioned ‘strict interpretation’ in the practice of the *fisc*. It is nonetheless submitted that the legislative intention (referred to above) with this concession provides ample justification for the class privilege bestowed on farmers, and adherence to the strict interpretation of these provisions should not cause one to lose sight of that intention.

Before the individual provisions of paragraph 12(1) are considered in more detail, a number of general requirements are apposite. For expenditure envisaged in paragraph 12(1) to be deductible by a farmer, it must be incurred by him personally,<sup>81</sup> and must be in connection with his own farming operations.<sup>82</sup> However, paragraph 12 does not require that a farmer must be the owner of the farmland in respect of which expenditure envisaged in paragraph 12(1) was incurred, as a prerequisite for deductibility.<sup>83</sup>

An overview of the various items of expenditure which are deductible in terms of paragraph 12(1) (read with paragraph 12(3)), reveals that most of them are limited in that although they are fully deductible, it is only to the extent that there is taxable farming income. Expenditure of the kind envisaged in item (a) (the eradication of noxious plants and alien invasive vegetation) and item (b) (the prevention of soil erosion) are the exceptions, seeing as they are deductible in full in the year of assessment in which they were incurred,<sup>84</sup> and can be set off against farming or non-farming income, even if that results in an assessed loss.<sup>85</sup> The favourable treatment in respect of the aforementioned expenditure is particularly laudable, as alien vegetation, invasive plants and soil erosion pose considerable threats to South Africa’s biological diversity, depleting water resources and damaging arable land.<sup>86</sup> This is an indication that the legislature uses fiscal policy as a valuable tool in advancing the agricultural industry, while simultaneously seeking to promote nature conservation.

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<sup>80</sup> R H Zulman *Income Tax Practice Manual* (September 2008) A:F11.

<sup>81</sup> De Koker *Silke* (note 11 above) 15.30, with reference to ITC 280 7 SATC 251.

<sup>82</sup> *Ernst v CIR* (note 67 above) 342 – 343.

<sup>83</sup> *Stiglingh Silke* (note 11 above) 601.

<sup>84</sup> Zulman (note 80 above) A:F11, with reference to *Odendaal v KBI* (note 73 above).

<sup>85</sup> *The Law of South Africa* (note 31 above) 553.

<sup>86</sup> A Paterson *Tax Incentives – Valuable tools for biodiversity conservation in South Africa* 204 – 206.

On the other hand, the types of expenditure envisaged under items (c) to (i) are 'ring-fenced' so as to prevent the abuse of the concessions.<sup>87</sup> These provisions briefly include expenditure in respect of dipping tanks, irrigation, fences, buildings, certain planting activities, roads and bridges and electricity.<sup>88</sup> Expenditure on these items can thus only be deducted from taxable income derived from farming operations.<sup>89</sup> Any excess of such deductions may be carried forward and set off against taxable income from farming in succeeding years of assessment, as long as the taxpayer continues to carry on farming operations.<sup>90</sup> In addition, the amount carried forward may be reduced in a succeeding year of assessment by recoupments in respect of movable assets arising in that year, if certain circumstances are present.<sup>91</sup>

A highly significant type of expenditure for purposes of this study, namely that in respect of buildings used in connection with farming operations,<sup>92</sup> is discussed in 2.3.3 below.

A further provision of considerable significance was previously contained in paragraph 12(1),<sup>93</sup> namely an outright deduction of the purchase price of *inter alia* machinery and other articles used by a farmer for farming purposes.<sup>94</sup> This outright deduction has been removed from the First Schedule, however, and replaced by a so-called 'phased' deduction or depreciation allowance in terms of section 12B(1)(f),<sup>95</sup> which allows a 50:30:20 deduction over three years of the cost of any machinery, implement, utensil or article (other than livestock).<sup>96</sup> It is further required that such an asset must be 'brought into use for the first time by that taxpayer and used by him or her in the *carrying on of his or her farming operations*,<sup>97</sup> (emphasis added). It is submitted that the emphasised phrase is a welcome instance of consistency in the Act, seeing as the wording echoes that of section 26(1). This consistency is especially helpful, seeing as there is a considerable body of case law and commentary which deals with the interpretation of the wording of the latter section, as discussed in 2.2 above. It is submitted that the aforementioned authorities may thus also be relied upon in interpreting the provisions of section 12B(1)(f).

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<sup>87</sup> Williams *Law and Practice* (note 12 above) 756.

<sup>88</sup> Paragraph 12(1)(c) - (i).

<sup>89</sup> Paragraph 12(3).

<sup>90</sup> Paragraph 12(3); *The Law of South Africa* (note 31 above) 553.

<sup>91</sup> Paragraph 12(3B); *The Law of South Africa* (Ibid).

<sup>92</sup> Paragraph 12(1)(f).

<sup>93</sup> Namely item (j), which was repealed by section 45(a) of the Income Tax Act No. 113 of 1993.

<sup>94</sup> *The Law of South Africa* (note 31 above) 552.

<sup>95</sup> Williams *Law and Practice* (note 12 above) 755.

<sup>96</sup> In other words, a deduction of 50% of the cost to the taxpayer of the asset in the first year of its use, 30% in the second year and 20% in the third.

<sup>97</sup> Section 12B(1)(f).

### 2.3.3. PARAGRAPH 12(1)(f)

The remaining provision contained in paragraph 12(1), namely item (f), provides for the deduction of expenditure incurred in respect of ‘the erection of, or extensions, additions or improvements (other than repairs) to, buildings used in connection with farming operations, other than those used for domestic purposes.’ Seeing as the capital assets envisaged in this item often represent significant costs to taxpayers (and are likely amongst their most valuable assets), the prospect of a 100% deduction of expenditure incurred in respect thereof, is highly advantageous. Before considering an alarming recent legislative amendment hereto, the meaning of the most relevant wording of paragraph 12(1)(f) is briefly considered.

Firstly, it is submitted that the phrase ‘erection of, or extensions, additions or improvements (other than repairs) to ...’ is of sufficient clarity and identifiable scope so as to accurately describe which types of activities in relation to ‘buildings’ may give rise to deductible expenditure in terms of paragraph 12(1)(f). By contrast, the meaning of the word ‘building’ in the context of paragraph 12(1)(f), although apparently straightforward, has been the subject of considerable scrutiny. It has been held, for example, that ‘a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof, and the necessary appurtenances thereto.’<sup>98</sup> It has been noted further that the word ‘building’ ‘is not used in a technical sense’ in this context, and ‘the question of what appurtenances form part of a building for the purposes of para 12(1)(f) is a question of fact.’<sup>99</sup> In light of the foregoing, it is submitted that a farmer seeking to claim an allowance under paragraph 12(1)(f) should ensure that his / her factual circumstances clearly justify the description of the particular structure as a ‘building’ or an ‘appurtenance thereto’.

Next, the interpretation of the expression ‘in connection with’ deserves brief mention. As for this phrase generally, which appears frequently in the Act,<sup>100</sup> it has been held to have ‘a wide and comprehensive meaning, but not so wide or comprehensive as to embrace a

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<sup>98</sup> De Koker, *Silke* (note 11 above) 15.34, with reference to the majority decision in *CIR v Le Sueur* 1960 (2) SA 709 (A), 23 SATC 261.

<sup>99</sup> *Ibid*, 15.34.

<sup>100</sup> The phrase ‘in connection with’ appears, for example, in paragraph (g)(ii) of the ‘gross income’ definition in section 1; section 4(1); section 8(1)(d); section 9(1)(b4); section 9D(10)(a)(iv)(bb); section 11D(13); section 11sex(c); section 22(3A); section 23(b); section 23C(1) and section 24H(4), to name a few instances.

remote and indirect connection,' that it envisages 'a direct connection ... subservient and ancillary to the particular business,' and that 'the true position is that while the closest and most intimate relationship is not necessary, it is not enough to show merely a loose and remote one.'<sup>101</sup>

The importance of the word 'used' which precedes the phrase 'in connection with' was also emphasised by the Court in the case referred to above, noting that 'while the buildings might be useful or desirable or even necessary from the taxpayer's point of view, (it) will not justify the deduction of their cost, if, in fact, the buildings are not used in, or in connection with, farming operations.'<sup>102</sup> Finally, in finding against the taxpayer, the Court held that it was not sufficient for the taxpayer to show that there was simply 'any use at all in connection with farming operations', but rather that 'the predominant use of the buildings was in connection with farming operations ... (and) it would not suffice if such use was merely ancillary or subordinate to the use of the buildings for (other) purposes.'<sup>103</sup>

As the meaning of the subsequent phrase, 'farming operations', has already been considered in a similar context (2.2.3 above), the last remaining portion of paragraph 12(1)(f) discussed below is the specific exclusion set out in the phrase 'other than those (buildings) used for domestic purposes.'

While paragraph 12(1)(f) still provides for a very favourable concession to farmers, it must be noted that a recent amendment<sup>104</sup> thereto considerably narrows the range of possible deductions allowed in terms thereof. The legislature effected this startling amendment by removing the emphasised words in the following portion of paragraph 12(1)(f): '...buildings used in connection with farming operations, other than those used for **[the]** domestic purposes **[of persons who are not employees of such farmer]**.'<sup>105</sup>

The result of this amendment is that, with effect from 21 October 2008, farmers are no longer entitled to a preferential deduction under paragraph 12(1)(f) for expenditure incurred by them in respect of housing for their employees.<sup>106</sup> Prior to this amendment, the

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<sup>101</sup> Per Herbststein J in *ITC 885* 23 SATC 336 (C) 338, quoting his own remarks from *Income Tax Appeal No. 5647* (not reported), after a consideration of relevant English authorities and case law.

<sup>102</sup> *ITC 885* (note 101 above) 338 – 339. This case dealt with the application of a similarly worded provision in an earlier incarnation of the Act (note 68 above), where the taxpayer claimed a capital allowance in respect of the costs of erection of buildings comprising a 'health centre' on its farm. The dispute revolved around whether the buildings were used *in connection with* the taxpayer's farming operations.

<sup>103</sup> *Ibid*, 340.

<sup>104</sup> In terms of section 57 of the Revenue Laws Amendment Act No. 60 of 2008.

<sup>105</sup> *Ibid*, section 57(1)(b) read with section 57(2).

<sup>106</sup> I Wilson, *A Tax Blow for Farmers Slips by Unnoticed* (May 2009) 3.

effect of paragraph 12(1)(f) was to entitle farmers to claim 'up to a maximum of R15,000 for any one employee irrespective of the number of buildings erected, extended, added to or improved.'<sup>107</sup> Even though the deduction previously allowed to farmers in this regard was thus limited, it was nonetheless a favourable incentive which provided farmers with excellent motivation to provide housing of good quality to their employees.<sup>108</sup>

Farmers who seek a similar deduction in future must now have recourse to the relevant provisions which are applicable to taxpayers in general, but which are not as favourable, i.e. those contained under section 13*sex*.<sup>109</sup> It remains to be seen what the legislative intention was with this far-reaching amendment, as no official explanation has been provided as of yet,<sup>110</sup> nor has any comment been forthcoming from the agricultural industry thus far.<sup>111</sup>

## 2.4. CONCLUSION – FARMING OPERATIONS

This chapter set out to identify the legislative provisions pertaining to taxpayers who derive income from farming operations, as relevant for purposes of this study. The most important principles which have arisen during the course of this discussion are, in brief, the following.

Taxpayers who carry on farming operations (whether it be in the form of 'pastoral', 'agricultural', or 'other farming operations'), may qualify for favourable fiscal treatment under the Act. Section 26(1) determines that the taxable income derived by a taxpayer who carries on such operations will be dealt with in terms of the Act in general, but will also qualify for the favourable concessions and other provisions of the First Schedule. It is thus important to determine, firstly, whether a taxpayer is indeed 'carrying on' such operations, and it has been held that the test in this regard is entirely subjective – i.e. whether the taxpayer intended to carry on farming operations. Regard may nonetheless be had to

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<sup>107</sup> De Koker, *Silke* (note 11 above), 15.34.

<sup>108</sup> Wilson (note 106 above) 3.

<sup>109</sup> Wilson (note 106 above) 3. Such a farmer would then have to comply with the various requirements of section 13*sex*, which allows for a deduction of 5% of the acquisition cost to a taxpayer of new and unused residential units (or improvements thereto) – *inter alia* he must own at least five residential units that are used solely for the purposes of his trade.

<sup>110</sup> The Explanatory Memorandum on the Revenue Laws Amendment Bill (2008), at 71, refers only to the rationale for the insertion of items (1A) and (1D) into paragraph 12, both of which deal with expenditure incurred in relation to the conservation or maintenance of farmland. No mention is made of the reasoning behind the amendment to paragraph 12(1)(f).

<sup>111</sup> Wilson (note 106 above) 3.

additional factors (such as a reasonable prospect of profit), but only for purposes of confirming the taxpayer's claimed intention.

As for the meaning of the terms 'pastoral' and 'agricultural' in section 26(1), these terms are of a specific nature, and include, generally, the production of stock and produce from a land-based economy. The subsequent phrase in that section, 'other farming operations', in contrast, is of a general nature. While the latter phrase does have a wide ambit, it must be construed in light of the preceding specific terms. The subsequent requirement in section 26(1), that taxable income must be 'derived from' the abovementioned farming operations, indicates principally that a direct causal connection is required between the taxpayer's farming operations and the resultant income. This requirement involves a question of fact which must be determined with regard to the taxpayer's circumstances.

If all the relevant requirements of section 26(1) are satisfied, the favourable concessions and other provisions of the First Schedule (and some which are found elsewhere in the Act) may thus apply to the taxpayer's farming income. These concessions include *inter alia* deductions in respect of the cost of machinery, the determination and treatment of the value of livestock and produce, and deductions in respect of 'capital development expenditure'. Paragraph 12(1)(f) is of particular importance, as it allows farmers a deduction in respect of buildings used in connection with farming operations – a highly favourable dispensation in the context of the Act. It has been held that these concessions place farmers in a privileged position as a class, and the relevant provisions must thus be strictly interpreted. This is a principle of considerable significance which, it is submitted, should be taken into account at all times when the favourable concessions available to farmers under the Act are sought to be applied. This principle is especially relevant, as will be shown in chapter 6, when a farmer seeks to apply such concessions to a process of manufacturing.

In the following chapter, the legislative context pertaining to taxpayers carrying on processes of manufacture will be considered, before the main focal point of this study is introduced.

### 3. MANUFACTURING – LEGISLATIVE CONTEXT

#### 3.1. INTRODUCTION

There are a number of provisions in the Act which provide concessions to taxpayers who carry on manufacturing processes or processes which, in the opinion of the Commissioner of SARS,<sup>112</sup> are of a similar nature. These concessions are not, it is submitted, equal in scope to or as favourable as the concessions available to taxpayers who carry on farming operations. There is not, for example, a separate schedule to the Act dealing with the computation of taxable income derived from manufacturing processes, nor are there any provisions applicable to manufacturers which mirrors the favourable treatment afforded to farmers in terms of paragraph 12(1) of the First Schedule.

An extensive body of case law has arisen as a result of disputes between the Commissioner and taxpayers regarding the interpretation of the legislative provisions applying to manufacturers. The most pertinent of these provisions and case law for purposes of this study will be considered in this chapter.

It may be noted, firstly, that both sections 12B and 12C previously provided for allowances to taxpayers in relation to certain qualifying capital assets (i.e. ‘machinery’ or ‘plant’) used by them directly in ‘a process of manufacture ... or any other process ... which in the opinion of the Commissioner is of a similar nature.’<sup>113</sup> However, the relevant provisions in section 12B(1) dealing with such assets have recently been repealed,<sup>114</sup> and thus the only remaining allowance in respect of ‘machinery’ or ‘plant’, aimed at taxpayers in general who carry on a process of manufacture, is contained in section 12C. The provisions of section 12C will be analysed below (in 3.2).

There is further a highly favourable allowance in section 12E which applies specifically to ‘small business corporations’ (as defined in that section),<sup>115</sup> namely a deduction of the full cost of a qualifying asset used directly in a process of manufacture in the first year of use.<sup>116</sup> However, as section 12E deals with a very specific type of taxpayer whose factual

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<sup>112</sup> Henceforth referred to as the ‘Commissioner’.

<sup>113</sup> Section 12C(1)(a) and (b).

<sup>114</sup> Section 12B(1)(a) and (b) were repealed by section 19(b) of Act No. 31 of 2005.

<sup>115</sup> Namely any close corporation, co-operative or any private company, with natural persons as shareholders, where the gross income does not exceed R14 million, subject to certain additional requirements – refer to the definition of ‘small business corporation’ in section 12E(4).

<sup>116</sup> Section 12E(1)(a) and (b).

circumstances must strictly comply with the provisions of that section, it is of too narrow application for purposes of this study.

Sections 12G and 12I also contain concessions in respect of a specified group of taxpayers who carry on, *inter alia* 'manufacturing' of various items, under so-called 'industrial projects'.<sup>117</sup> While these concessions are aimed at 'attracting foreign investment in ... projects ... of strategic economic importance to the Republic,'<sup>118</sup> and to encourage 'investment, upgrades and expansions in the manufacturing sector,'<sup>119</sup> the various requirements of these concessions (especially regarding the magnitude of the projects) place them out of reach of the average taxpayer carrying on a process of manufacture, as envisaged by section 12C. Accordingly, the concessions contained in these sections are not included in the ambit of this study.

Finally, Section 13 provides for an annual deduction of a specified percentage of the cost of certain qualifying buildings or improvements thereto (excluding repairs) used by taxpayers in carrying on manufacturing processes (or, in certain instances, any other process which in the opinion of the Commissioner is of a similar nature). As will be shown below, the quantum of the allowance (i.e. what percentage of the cost of the building is allowed as an annual deduction) depends on the date of the erection or acquisition of the building.

This chapter will thus further analyse sections 12C and 13, with the emphasis on the former section, and the interpretation of the provisions of these sections, where relevant, with the aid of legal precedent and commentaries. It will appear from this chapter that taxpayers who carry on a process of manufacture may be entitled to certain concessions, depending on their factual circumstances, but that they are ultimately not treated as favourably as taxpayers who derive income from farming operations. The implications of this point will be elaborated upon in chapter 5.

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<sup>117</sup> 'Industrial project' is defined in sections 12G(1) and 12I(1), but is not relevant for present purposes.

<sup>118</sup> Williams *Law and Practice* (note 12 above) 407, with reference to section 12G.

<sup>119</sup> The Explanatory Memorandum (note 110 above) 66.



## 3.2. INTERPRETATION OF SECTION 12C

### 3.2.1. GENERAL

The legislative intentions behind a depreciation allowance (such as that contained in section 12C) are twofold.<sup>120</sup> Firstly, as it allows the deduction of the acquisition cost of capital assets over a relatively short period, it provides an incentive for taxpayers to continually modernise their equipment, with expected benefits in improved industrial output. Secondly, taxpayers who do not have access to such a depreciation allowance (and are unable to recover the real cost of the asset) may see the price of replacement assets rise considerably in an environment of high inflation – the depreciation allowance thus gives financial relief in such cases.<sup>121</sup> It is clear that accelerated depreciation allowances are an effective method of providing fiscal assistance to taxpayers who carry on manufacturing processes. Section 12C is a prime example of a depreciation allowance seeking to achieve the objectives referred to above.

The provisions of section 12C which are relevant for purposes of this study include a depreciation allowance in respect of machinery or plant owned or acquired by a taxpayer for use by him or by his lessee in a process of manufacture. The number of years and annual percentage of the allowance will depend on whether the machinery or plant is new or used.

Section 12C(1)(a) provides for a deduction in respect of any:

*'machinery or plant ... owned ... or acquired by the taxpayer ... (and) brought into use for the first time (by him) for the purposes of his trade (other than mining or farming), and used by him directly in a process of manufacture carried on by him or any other process carried on by him which in the opinion of the Commissioner is of a similar nature.'*<sup>122</sup> (Emphasis added.)

The deduction which may be allowed in such an instance is 20% per year (i.e. over five years) of the cost to the taxpayer to acquire that machinery or plant, in the case of machinery which is not new or unused. On the other hand, if a taxpayer as envisaged in section 12C(1)(a) acquires new or unused machinery or plant for the abovementioned use on or after 1 March 2002, the deduction will be more favourable, i.e. 40% of the said cost

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<sup>120</sup> Williams *Law and Practice* (note 12 above) 393.

<sup>121</sup> Ibid.

<sup>122</sup> Section 12C(1)(a). The ambit of the phrase 'process ... which in the opinion of the Commissioner is of a similar nature,' has a wider ambit than the phrase 'process of manufacture.' The focus of this study is on the lastmentioned phrase, which has a more specific meaning and has been the subject of most judicial scrutiny.

in the year in which the asset is first brought into use, and 20% per year for three years thereafter (i.e. over four years instead of five).<sup>123</sup>

Section 12C(1)(b) also provides for a deduction of 20% per year as described above, but differs in the respect that the deduction is allowed to taxpayers who own or acquire machinery or plant and lease the assets out. In those cases, the deduction is allowed if the asset is brought into use for the first time by the *lessee* for the purposes of his trade (excluding mining or farming) and is used by the lessee directly in a process of manufacture carried on by him, or any other process which in the opinion of the Commissioner is of a similar nature. The brief discussion which follows regarding the interpretation of the wording of section 12C(1) (3.2.2 below) is confined to subsections (a) and (b) referred to above.<sup>124</sup>

The Commissioner has issued a Practice Note which sets out lists of processes which are regarded as processes of manufacture, processes similar to manufacture, and processes which are not regarded either as processes of manufacture or processes similar to manufacture.<sup>125</sup> While the lists in the latter Practice Note may be useful tools for guidance purposes, taxpayers are not bound by them.<sup>126</sup> It should also be noted that any decision made by the Commissioner under section 12C (i.e. whether a process is or is not a 'process of manufacture') is subject to objection and appeal by the taxpayer concerned.<sup>127</sup>

Finally it is notable that, even if the allowance under section 12C does not apply (e.g. if the 'machinery or plant' was not brought into use for the first time by the taxpayer or his lessee), the taxpayer may still seek to obtain a deduction for wear and tear or depreciation in terms of section 11(e).<sup>128</sup> An evaluation of the provisions of section 11(e) is beyond the scope of this study, as the focus of this chapter is on the provisions specifically applicable

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<sup>123</sup> Section 12C(1) proviso (c).

<sup>124</sup> This is due to the fact that the rest of the provisions of section 12C(1) refer to specific taxpayers, i.e. agricultural co-operatives, hotelkeepers and owners of aircraft or ships – section 12C(1)(c) - (g). The ambit of this study does not include consideration of the limited provisions applicable to such specific taxpayers.

<sup>125</sup> *Practice Note: No. 42* (27 November 1995) and Annexures A, B and C thereto; *Professional Tax Handbook 2008 / 2009*, 627. Interestingly, while the lists contained in Annexure B (Processes of Manufacture) and Annexure C (Processes not Regarded as Processes of Manufacture or Processes Similar to a Process of Manufacture) are specifically described in the Practice Note as not being exhaustive, no such qualification precedes Annexure A (Processes Similar to Processes of Manufacture). This is evidently due to the fact that the latter processes '*have been accepted* as processes similar to a process of manufacture' (emphasis added), as noted in the Practice Note, and thus Annexure A appears to be merely a recordal of previous decisions in this regard, i.e. an exhaustive list.

<sup>126</sup> Meyerowitz (note 44 above) 12.152.

<sup>127</sup> Section 3(4)(b).

<sup>128</sup> Meyerowitz (note 44 above) 12.149.

to taxpayers who carry on a process of manufacturing and are entitled to the Section 12C allowance.<sup>129</sup>

In the discussion which follows, the interpretation of some of the more contentious phrases (none of which are defined in the Act) in the relevant provisions of section 12C(1) are briefly considered, with reference to case law and commentary.

### 3.2.2. 'MACHINERY OR PLANT'

In considering the wording of the applicable portions of section 12C(1), the first relevant phrase which has given rise to some debate, refers to the type of assets concerned, namely 'machinery or plant'. The term 'machinery' may be defined in general terms as 'machines collectively' or 'the components of a machine', while the root noun 'machine' means 'an apparatus using mechanical power and having several parts, each with a definite function and together performing a particular task'.<sup>130</sup> While the interpretation of this term has not been the subject of judicial consideration by our Courts, it arguably has a fairly easily identifiable scope. Taxpayers should thus not be left with much uncertainty as to what assets might accurately be described as 'machinery'.

The word 'plant', on the other hand, has been the subject of some debate. It has been noted that the reference to 'machinery *or plant*', has the effect of widening the ambit of the allowance in section 12C(1)(a) and (b).<sup>131</sup> This wide ambit, it is submitted, is demonstrated by the fact that the word 'plant' may be defined as including fixtures, implements, machinery and apparatus used in carrying on any industrial process.<sup>132</sup> In the case of *Blue Circle Cement*, dealing with an earlier provision preceding section 12C<sup>133</sup> (which was similar in many respects to the current legislation), the Appellate Division (as it then was) investigated the meaning of the word 'plant' in the context of a taxpayer claiming a depreciation allowance in respect of railway lines used to convey material from the

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<sup>129</sup> The allowance in section 11(e) may be applicable to and useful for a taxpayer who uses an asset in a process of manufacture, and for example does not have a cost for the asset or who acquires the asset at the end of a lease.

<sup>130</sup> *The Oxford Dictionary* (note 14 above) 1052.

<sup>131</sup> *Meyerowitz* (note 44 above) 12.150.

<sup>132</sup> *Blue Circle Cement Ltd v CIR* 1984 (2) SA 764 (A), 46 SATC 21 at 30, quoting from the *Oxford English Dictionary*.

<sup>133</sup> Namely section 12, which provided for the so-called 'machinery initial allowance' and 'machinery investment allowance,' was repealed by Act No. 129 of 1991.

taxpayer's quarry to its factory, which railway lines were averred by the taxpayer to be 'plant'.<sup>134</sup>

A number of important principles may be gleaned from the judgment in this case. Firstly, the Appellate Division espoused the so-called 'functional test' as a useful tool for deciding whether a structure may or may not properly be referred to as 'plant'. This test basically seeks to determine the way in which the 'subject-matter' is being used, and if it is 'the apparatus or part of the apparatus' which is being used in carrying on the activities of the taxpayer's business, it may rightly be regarded as 'plant.' The Court further favoured a 'common-sense approach' in deciding whether an item may be regarded as 'plant', and noted additionally that each case must be decided on its own facts.<sup>135</sup>

Ultimately, the Court found in favour of the taxpayer, holding that the railway lines were 'part and parcel of the appellant's industrial process', and there was no reason for it not to be regarded as 'apparatus used in carrying on the industrial process' in which the taxpayer was engaged.<sup>136</sup> In reaching its conclusion, the Court regarded the durable nature of the railway lines as further proof that it had all the characteristics of 'plant', and that the size of an item of apparatus cannot, without more, prevent it from being considered to be 'plant', provided the relevant characteristics of 'plant' are otherwise all present. The Court thus held that the railway line did constitute 'plant', and that the taxpayer was entitled to the applicable allowances.<sup>137</sup>

The foregoing principles set out by the Appellate Division have been put to frequent and productive use, having been applied in a number of subsequent cases in considering similar issues (i.e. whether certain items constitute 'plant' within the meaning of legislation similarly worded to section 12C).<sup>138</sup>

### 3.2.3. 'USED ... DIRECTLY IN...'

The past tense form of the verb 'used' should not give rise to much misunderstanding in the context of section 12C, and may be defined as to 'take, hold, deploy (something) as a

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<sup>134</sup> *Blue Circle Cement Ltd v CIR* (note 132 above).

<sup>135</sup> *Ibid*, 31 – 32.

<sup>136</sup> *Ibid*, 33.

<sup>137</sup> *Ibid*.

<sup>138</sup> For instance *ITC 1468 52 SATC 32 (C) 35, 38*; *ITC 1469 52 SATC 40 (C) 43*; and *ITC 1479 52 SATC 264 (T) 273 – 274*.

means of accomplishing or achieving something; employ'.<sup>139</sup> It is submitted that this word indicates that an active process of putting the 'machinery or plant' to use is envisaged in order to qualify for the allowance, and not merely the preserving thereof as an investment, for example. Put differently, where this phrase is employed in a similar manner elsewhere in the Act, it has been held to mean that the subject thereof must be more than merely 'useful or desirable or even necessary,' but must in fact be *used* in the particular operation.<sup>140</sup> It is submitted that the foregoing comments are applicable in the context of section 12C, seeing as the word 'used' is employed in a similar fashion.

The adverb 'directly', however, requires closer scrutiny. This term may be defined as 'with nothing or no one in between,'<sup>141</sup> or 'without the intervention of a medium; immediately; by a direct process or mode'.<sup>142</sup> It has further been held that the use of this word in this particular context indicates that the legislature intended to distinguish between 'plant or machinery directly used in a process of manufacture ... and plant or machinery which is indirectly so used,' and that 'full effect must be given to this intention.'<sup>143</sup> In the same case, the preposition 'in' after the word 'directly', was held to require the 'direct participation in the process of manufacturing' of the relevant 'machinery or plant'.<sup>144</sup> This *dictum* was applied with approval in a subsequent case.<sup>145</sup>

In the *Cape Lime* case, the Appellate Division considered the application of this phrase in the context of a taxpayer seeking to claim capital allowances in respect of certain lorries (trucks) which it used in its operations, namely the production of hydrated lime.<sup>146</sup> In this case it was common cause that the taxpayer was carrying on a 'process of manufacture', with the dispute revolving around the question as to whether the taxpayer had used the lorries 'directly in' such process.<sup>147</sup> In seeking to resolve the foregoing question, the Court regarded as paramount the enquiry, as a matter of law, into where such process commences and where it ends.<sup>148</sup> After having identified where the process begins (with slightly differing emphasis among the three concurring judgments), the majority of the

<sup>139</sup> *The Oxford Dictionary* (note 14 above) 1942.

<sup>140</sup> Refer to 2.3.3 above regarding paragraph 12(1)(f), where judicial interpretation of the word 'used' is discussed in the context of the latter paragraph (with reference to the *dicta* in ITC 885 (note 101 above)).

<sup>141</sup> *The Oxford Dictionary* (note 14 above) 492.

<sup>142</sup> ITC 1061 26 SATC 317 (C) 319, quoting from the *Shorter Oxford English Dictionary*.

<sup>143</sup> *Ibid*, 318 – 319.

<sup>144</sup> *Ibid*, 319.

<sup>145</sup> ITC 1445 51 SATC 40 (T) 47.

<sup>146</sup> *SIR v Cape Lime Co Ltd* 1967 (4) SA 226 (A), where the Court once again considered the possible application of the repealed section 12 (note 133 above).

<sup>147</sup> *Ibid*, 235.

<sup>148</sup> *Ibid*, 236.

Court agreed that the lorries were indeed used ‘directly in’ the process of manufacture. It is submitted that the conclusion that the lorries were predominantly used for carrying or transporting the raw material from the commencing part of the process to a further part thereof, was the deciding factor in favour of the taxpayer.<sup>149</sup> In other words (to paraphrase the judgment of the Special Court in that instance), the movement of the raw material by the lorries was an integral part of the process of manufacture, and they were thus used ‘directly in’ that process.<sup>150</sup>

It is submitted that the principles above provide clear guidelines which may be applied in considering whether an item of ‘machinery’ or ‘plant’ is used by a taxpayer ‘directly in’ a ‘*process of manufacture*’. The latter emphasised phrase is the final relevant portion of the wording of section 12C(1) which has been the subject of considerable scrutiny, and the interpretation thereof is discussed below.

#### 3.2.4. ‘PROCESS OF MANUFACTURE’

The term ‘process’ may be defined as ‘a series of actions or steps taken in order to achieve a particular end; *a systematic series of mechanised or chemical operations that are performed in order to produce something.*’<sup>151</sup> (Emphasis added). The emphasised portion of the definition is especially apt to describe the meaning which is probably intended to be conveyed by the word in the context of section 12C. The term ‘manufacture’ is not defined in the Act either, and if regard is had to the dictionary meaning, the word may be defined as to ‘make (something) on a large scale using machinery.’<sup>152</sup> Fortunately, as will be shown below, the Courts have considered this phrase in some detail, setting out helpful guidelines.

The Appellate Division has passed down two influential judgments where the meaning of the phrase ‘process of manufacture’ was investigated in considerable detail.<sup>153</sup> In the first case, that of *Hersamar*, the taxpayer’s operations involved the processing of scrap metal in a specific manner so as to prepare it for sale to foundries, which then used the scrap metal

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<sup>149</sup> *SIR v Cape Lime Co* (note 146 above), per the judgments of Wessels JA at 234, Smit AJA at 237 – 238 and Jennett AJA 240 – 241.

<sup>150</sup> *Ibid*, 237.

<sup>151</sup> *The Oxford Dictionary* (note 14 above) 1403.

<sup>152</sup> *Ibid*, 1070.

<sup>153</sup> *SIR v Hersamar (Pty) Ltd* 1967 (3) SA 177 (A), and *SIR v Safranmark (Pty) Ltd* 43 SATC 235, 1982 (3) SA 113 (A).

for smelting.<sup>154</sup> For purposes of carrying out the aforementioned process, the taxpayer purchased various items of equipment and claimed certain capital allowances in respect of the expenditure thereon, under an earlier version of the Act.<sup>155</sup>

In considering the meaning of the phrase ‘process of manufacture’, the majority of the Court agreed that such a process has taken place if it resulted in a product which is *essentially different* from the existing article before being subjected to the process.<sup>156</sup> However, the Court stressed that the sufficiency of the change is a question of degree, that there are no fixed criteria as to when such a change had indeed taken place, and that it can only be answered by due consideration of the facts at hand.<sup>157</sup>

In finding in favour of the taxpayer (i.e. that it was eligible for the allowances claimed) the majority held that the taxpayer’s machines were indeed used in a ‘process of manufacture’, as the ultimate product thereof was found to be ‘essentially different’ to the original raw material. This was found to be the case even though the process did not bring about a change in the metallurgical composition of the material – i.e. it was still the same material, in a physical sense, as its constituent ingredients. The determining factor in this case was that the end products of the manufacturing process were specific articles – so-called ‘briquettes and blocks’, which were basically compressed pieces of steel created from scrap by the taxpayer’s process – with considerable utility and commercial purpose. These articles were suitable for sale to the taxpayer’s main customers (steel manufacturers), whereas the raw material (unprocessed steel scrap) did not have these characteristics and was not a saleable commodity to the main purchasers.<sup>158</sup>

The second case heard before the Appellate Division in this regard, namely that of *Safranmark*,<sup>159</sup> involved a taxpayer claiming certain capital allowances in respect of plant and machinery used by it in preparing fried chicken for sale to the public.<sup>160</sup> As it was common cause that the machines were used by the taxpayer directly in its operations, the

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<sup>154</sup> *SIR v Hersamar* (note 153 above) 273 – 274.

<sup>155</sup> In terms of section 11(2)(d)*bis*(i) (similar to the current section 12C(1)) of the Income Tax Act No. 31 of 1941 (repealed), which provided for an allowance in respect of ‘new or unused machinery or plant brought into use by the taxpayer for the purposes of his trade’ and which was ‘used by the taxpayer directly in a process of manufacture.’ *SIR v Hersamar* (note 153 above) 271.

<sup>156</sup> *Ibid*, 275, with reference to *ITC 1052* 26 SATC 253 at 255.

<sup>157</sup> *Ibid*, 275.

<sup>158</sup> *Ibid*, 275 – 276.

<sup>159</sup> *SIR v Safranmark* (note 153 above).

<sup>160</sup> In terms of the repealed section 12 of the Act (note 133 above).

issue before the Court was whether the taxpayer used the plant and machinery in a 'process of manufacture.'<sup>161</sup>

In the majority judgment, the Court reiterated firstly that the question whether on the facts at hand, a taxpayer's activities constitute a process of manufacture, is one of law.<sup>162</sup> Next, the Court cited and agreed with all of the relevant principles set out in *Hersamar's* case as discussed above, which it then applied in order to determine whether a process of manufacture was carried out by the taxpayer in the present case, in its process of cooking fried chicken.<sup>163</sup>

In this case, however, in contrast to *Hersamar's* case, the Court found on the facts that the end product of the process was completely different from its ingredients, noting that:

'The conclusion to be drawn from (the proven facts) ... is that not only did each of the ingredients cease to retain its individual qualities, but upon completion of the process a different compound substance having a special quality as such, viz edibility and special taste, has been produced, and moreover produced in quantity for purposes of trade.'<sup>164</sup>

Interestingly, the majority of the Court seems to have attached considerable weight to the quantity of the fried chicken produced by the taxpayer, as well as the 'scale of its operations' and the 'large volume of sales', noting that the addition of these factors to those quoted above are clear evidence that the machines were used in a process of manufacture.<sup>165</sup> It has been held, however, that the scale of a taxpayer's operations and the fact that a standardised product is created, are not of themselves sufficient factors to 'convert a particular operation which is not a process of manufacture into such a process.'<sup>166</sup> Care should thus be taken to highlight as many relevant considerations as possible in seeking to prove that an operation constitutes a 'process of manufacture', seeing as no one factor is likely to suffice on its own.

Based on the two cases cited above, it is submitted that taxpayers seeking to claim the capital allowance provided for under section 12C(1), may potentially have considerable scope for arguing that an activity undertaken by them qualifies as a 'process of manufacture'. While there are certain principles which have been accepted by the Appellate Division as indicative of such a process, and which may in themselves be of

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<sup>161</sup> *SIR v Safranmark* (note 153 above) 243.

<sup>162</sup> *Ibid*, 245.

<sup>163</sup> *Ibid*, 246 – 247.

<sup>164</sup> *Ibid*, 248.

<sup>165</sup> *Ibid*.

<sup>166</sup> *ITC 1458* 51 SATC 138 (T) 141.



considerable assistance to a taxpayer, the Court does not regard the aforementioned principles as hard and fast rules.

It further appears from the cases cited above, as well as the various cases which have subsequently applied the principles set out therein,<sup>167</sup> that the closest principle to a 'golden rule' in this regard is that the Court will carefully consider the factual circumstances of the taxpayer in deciding whether an operation constitutes a 'process of manufacture'.

If the type of activity carried on by the taxpayer has not previously been held (on similar facts) by the Courts to constitute a 'process of manufacture', the taxpayer should first have regard to the relevant Practice Note,<sup>168</sup> which while not binding may nonetheless be of assistance.<sup>169</sup> If neither prior precedent nor the Practice Note is of assistance, it is submitted that the taxpayer should carefully apply the principles regarding the interpretation of the relevant provisions of section 12C(1) to ascertain whether the allowance may be available.

Finally, in light of the comments, principles and authority discussed above, the taxpayer seeking to claim the relevant allowance under section 12C(1), should be advised to carefully consider the factual circumstances pertaining to the process itself, highlighting any factors which may indicate that the process is one of manufacture. It is submitted that such a careful consideration of the relevant facts, combined with the thorough application of the principles referred to above, should assist the taxpayer in identifying whether the allowance is applicable.

### 3.3. SECTION 13

A further concession in the Act aimed at the taxpayer who carries on a 'process of manufacture' in the course of his trade (other than mining or farming), is found in section 13. Simply put, this section provides for an annual allowance of either 2%, 5% or

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<sup>167</sup> Including *Automated Business Systems (Pty) Ltd v CIR* 1986 (2) SA 645 (T), 649; *ITC 1445* (note 145 above), 44 – 45; *ITC 1458* (note 166 above), 140 – 141; *CIR v Stellenbosch Farmers' Winery Ltd* (1988) 51 SATC 81 (CPD), 87; *Ovation Recording Studios (Pty) Ltd v CIR* (1990) 3 SA 682 (A), 52 SATC 163, 172; and *ITC 1591* 57 SATC 212, 219 – 220.

<sup>168</sup> Note 125 above.

<sup>169</sup> Refer to the discussion of Practice Note: No. 42 under 3.2.1 above.

10% of the cost (less any recoupments) of a qualifying building and any improvements (other than repairs) effected thereto, provided the requirements of the section are met.<sup>170</sup>

Broadly speaking, the main requirement common to the various subparagraphs in section 13(1) is that the relevant building must have been ‘wholly or mainly used during the year of assessment ... for the purpose of carrying on therein any process of manufacture in the course of his trade (other than mining or farming),’<sup>171</sup> by the taxpayer (or his lessee, as applicable). Whether a deduction will be available at all in respect of the abovementioned costs (and, if so, what percentage of such cost will be deductible), will depend in large part on the date of erection of the building or the date of commencement of the improvements thereto.

It is submitted that the terms and phrases in section 13 which are most likely to lead to interpretational difficulties are ‘building’, ‘wholly or mainly’, ‘used’, ‘carrying on’ and ‘process of manufacture’. Under various headings in this and the preceding chapter,<sup>172</sup> the interpretations of all of the aforementioned phrases were discussed, except that of ‘wholly or mainly’. As for the phrases already discussed, it is submitted that the principles of interpretation set out above are equally applicable in this context, and that the words should thus signify corresponding meanings, albeit in a different context.<sup>173</sup>

The phrase ‘wholly or mainly’ is not defined in the Act, and regard may thus be had, as a starting point, to the dictionary definitions of its constituent parts. The term ‘wholly’ may be defined as ‘entirely; fully,’<sup>174</sup> and ‘mainly’ as ‘more than anything else; for the most part.’<sup>175</sup> The interpretation of this phrase in the context of section 13 thus seems quite clear, i.e. that the building must be used for manufacturing purposes, either more so than for any other purpose (i.e. mainly), or only for manufacturing purposes (i.e. wholly). The question as to whether a building is used ‘wholly or mainly’ for carrying on therein any process of manufacture, is one of fact which must be decided on a review of all the

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<sup>170</sup> Section 13(1), provisos (b) and (c) thereto and section 13(3); Williams *Law and Practice* (note 12 above) 378.

<sup>171</sup> The additional phrase ‘... or any other process which in the opinion of the Commissioner is of a similar nature’ is only used intermittently in section 13(1), i.e. only in paragraphs (b), (d), (d4) and (f). Note further that the Commissioner’s decision is subject to objection and appeal by the taxpayer in terms of section 3(4)(b).

<sup>172</sup> Refer to 2.2.1, 2.3.3, 3.2.3 and 3.2.4 above.

<sup>173</sup> Even though the interpretation of the term ‘building’ and the phrase ‘carrying on’ was discussed in the context of taxpayers deriving income from farming operations (2.2.1 and 2.3.3 above), it is submitted that their usage in section 13 is in such a similar manner that the earlier comments are equally applicable in this context.

<sup>174</sup> *The Oxford Dictionary* (note 14 above) 2011.

<sup>175</sup> *Ibid*, 1059.

relevant facts and circumstances.<sup>176</sup> In practice, it appears that SARS requires more than 50% of a building (measured either by floor space or volume) to be used for manufacturing processes to qualify for the allowance.<sup>177</sup>

### 3.4. CONCLUSION – PROCESSES OF MANUFACTURE

This chapter has set out to identify the most important provisions of the Act containing concessions for taxpayers who carry on processes of manufacture, and to discuss the most relevant of the said concessions for purposes of this study. A brief overview of the most important points is as follows.

Firstly, it is noted that there is no separate schedule to the Act (such as the First Schedule) which deals with the determination of taxable income derived from processes of manufacture. In this regard, the most relevant provisions are contained in sections 12C and 13. Section 12C provides for an allowance in relation to ‘machinery’ or ‘plant’ used by taxpayers (or their lessees) directly in ‘a process of manufacture ... or any other process ... which in the opinion of the Commissioner is of a similar nature.’ Section 13, on the other hand, provides for an annual deduction of a percentage of the cost of certain qualifying buildings or improvements thereto (excluding repairs) used by taxpayers in carrying on manufacturing processes (or similar processes).

As the wording of section 12C may lead to interpretational difficulties, some important principles were discussed in this regard. The first phrase which was considered is ‘machinery or plant’. The term ‘plant’ has been the subject of most attention, seeing as it considerably widens the ambit of the section and should thus be interpreted with circumspection. It has been held that a ‘functional test’ may be applied to decide whether a structure may or may not properly be referred to as ‘plant.’ This test investigates how the subject-matter is being used – i.e., if it is ‘the apparatus or part of the apparatus’ used in carrying on the activities of the taxpayer’s business, it constitutes ‘plant’. The durable nature of an item may, *inter alia*, be taken into account in deciding whether an item constitutes plant, which is ultimately a question of fact. The next relevant phrase in section 12C which was considered, is ‘used ... directly in ...’. The term ‘used’ signifies that the item must not be merely useful or desirable, but must be actively employed in the

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<sup>176</sup> De Koker *Silke* (note 11 above) 8.17A.

<sup>177</sup> *Ibid.*

particular operation. The adverb ‘directly’ implies the use of the item in ‘direct participation in the process of manufacturing’, i.e. it must be an ‘integral part’ of the process, which may be the case if the item is used, for example, to aid in the progression of the said process from one phase to the next. The final phrase of relevance in section 12C is ‘process of manufacture’. It has been held that a process of manufacture will result in a product which is essentially different from the existing article before being subjected to the process. The sufficiency of the change for these purposes is a question of degree. Relevant factors which may be considered include, *inter alia*, the nature and extent of changes to the pre-existing article, increased utility and commercial purpose of the end product and the specialised nature of the plant and machinery used. Ultimately, however, it remains a question of fact whether an operation constitutes a ‘process of manufacture, and the Court will closely scrutinise the relevant circumstances in reaching its conclusion.

Lastly, in considering the phrase ‘wholly or mainly’ in section 13, it was concluded that for a building to qualify for the depreciation allowance, it should be used either more for manufacturing purposes than for any other purpose (i.e. mainly), or only for manufacturing purposes (i.e. wholly). The question is one of fact, however, which will be decided on a review of all the relevant facts and circumstances.

In light of this chapter and chapter 2 above, it is submitted that the concessions for manufacturers are not as favourable as those applicable to taxpayers carrying on farming operations. This submission is borne out, *inter alia*, by the following considerations. Firstly, there is no schedule to the Act, equivalent to the First Schedule, which contains a similar scope of concessions and provisions in respect of processes of manufacture specifically. Secondly, the concessions which are aimed at processes of manufacture are not as favourable as their counterparts applicable to taxpayers who carry on farming operations. For example, the 100% deduction in respect of buildings used in connection with farming operations (paragraph 12(1)(f), 2.3.3 above) is far more beneficial than the annual allowance in respect of manufacturing buildings in section 13 (3.3 above).<sup>178</sup>

The significance of the latter point will become evident in the remaining chapters of this study, where regard is had to taxpayers who may potentially qualify for the concessions under either of these two regimes *simultaneously*.

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<sup>178</sup> A further example is the 3-year depreciation allowance for farming equipment (section 12B(1)(f) - 2.3.2 above), compared to the 5- or 4-year allowance in respect of machinery or plant used in a process of manufacture (3.2 above).

## **4. WHERE DO 'FARMING OPERATIONS' END AND OTHER TRADES OR ACTIVITIES BEGIN?**

### **4.1. INTRODUCTION**

In the preceding chapters, consideration was given to the fiscal treatment of two distinctive types of trade or activity which may be carried on by taxpayers, namely farming operations on the one hand, and processes of manufacture on the other.<sup>179</sup> The chapters above focused on the relevant legislative provisions applicable to these distinctive trades or activities in isolation, as well as numerous instances of applicable case law and commentary. While it is thus submitted that the law in this regard is well-developed, this chapter and the following examine instances where the waters become somewhat murkier.

It has been noted that modern production methods may lead to difficulties in interpreting the wording of the legislation, particularly those provisions pertaining to farmers, which may be even more so in cases where the 'farming operations' of a taxpayer are not easily identifiable as such within the context of the legislation.<sup>180</sup> In cases where taxpayers carry on farming operations and manufacturing processes *simultaneously*, such difficulties may become particularly vexing. In particular, problems may arise for taxpayers who are part of a fairly modern trend: on the one hand, many farmers nowadays carry out activities with their produce beyond what is commonly known as 'farming operations', for example, processes of manufacture, marketing and distribution.<sup>181</sup> On the other hand, many manufacturers (for example, of foodstuffs) choose to produce their own ingredients, thus carrying out activities which may appear to be 'farming operations' but may not qualify for the farming concessions.<sup>182</sup>

Such instances may lead taxpayers to seek the application of concessions or favourable treatment available for certain activities, to *all* the operations carried on by them (i.e. both their farming operations and further activities). Not surprisingly, the Revenue authorities have challenged this type of approach, especially where favourable concessions aimed at a

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<sup>179</sup> Chapters 2 and 3 above.

<sup>180</sup> Meyerowitz (note 44 above) 20.5, 20.7 and 2.2.3 above.

<sup>181</sup> In most of the cases which are discussed below, the activities carried out by taxpayers in addition to their 'farming operations' were not 'processes of manufacture'. However, as will be shown, the principles which may be extracted from these cases are nonetheless applicable to farming / manufacturing scenarios.

<sup>182</sup> Meyerowitz (note 44 above) 20.7.

particular trade or activity are applied to operations which do not necessarily form part of that trade.

The focus of this chapter is on two cases which are examples of the trend referred to above. Both of these cases concerned persons who not only carried on 'farming operations', but also distributed their farming produce. The cases discussed below deal with a question which lies at the root of the conundrum faced by taxpayers who carry on farming operations and manufacturing processes simultaneously, namely: where do farming operations cease and other trades or activities begin? While our Courts may not yet have considered the latter question in so many words,<sup>183</sup> it is submitted that the following two cases have given us considerable guidance in this regard. While neither of these cases dealt with fiscal legislation, the Courts did consider wording in other statutes and by-laws which is similar to the wording currently used in the Act. It is thus submitted that these judgments are of considerable value, and a useful starting point.

In brief, the individual carrying on farming operations in the first case successfully argued that his additional distribution activities were included in his 'farming operations', whereas the distribution activities in the second case were found not to be so included. This chapter seeks to identify the distinguishing factors between the aforementioned cases, based on the varying facts, and to analyse the approaches followed by the Courts. While these cases were very specific to the particular factual circumstances, it is submitted that the general principles which do arise may assist taxpayers who find themselves in similar scenarios, to find an answer to the question referred to above. Ultimately, these principles will be applied in considering the focal point of the study (with the aid of actual and postulated scenarios), namely taxpayers who carry on farming operations and processes of manufacturing simultaneously.

#### 4.2. EMPLOYEES DISTRIBUTING A FARMER'S OWN PRODUCE

The first case, namely that of *Bryant v Minister of Labour and Minister of Justice*,<sup>184</sup> dealt with a dispute under the erstwhile Wage Act.<sup>185</sup> This case was brought before the Transvaal Provincial Division under an application for a declaration of rights, with the applicant seeking a declaration that his employees were engaged in 'farming operations.' If

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<sup>183</sup> *Meyerowitz* (note 44 above) 20.7.

<sup>184</sup> 1943 TPD 205.

<sup>185</sup> No. 44 of 1937.

point due to the absence of evidence that hawking had taken place.<sup>194</sup> The Court accordingly found in favour of the applicant and granted the declaratory order along the lines sought, i.e. ruling that all of the employees were engaged in farming operations, even with respect to the distribution of the applicant's produce.<sup>195</sup>

This case is an instance of judicial willingness to favour an holistic or inclusive view of farming operations as a collection of wide-ranging activities constituting a 'common enterprise', even though this may include activities which perhaps do not, within ordinary parlance, fall within the meaning of 'farming operations'. It is unfortunate, though, that the Court did not have the opportunity of considering whether the hawking or selling of farming produce at separate premises might also, without doing violence to the ordinary meaning of the term, constitute 'farming operations'. A consideration of this issue may have provided further useful guidelines. Even though the Court did not decide the aforementioned point, however, it is nonetheless submitted that farmers should take care not to dispose of their produce in a manner not closely connected to their farming operations, such as selling his / her produce from separate premises, for example. For if this were the case, it may be very difficult to prove that the said sales activities nonetheless form part of the farming operations as a mere concluding step thereof, as it may be too far removed therefrom and held instead to constitute a separate, independent trade.

A further notable feature of *Bryant's* case, even though it was not elaborated upon in the judgment, is that the distribution activities of the employees were limited to the applicant's own milk, i.e. only the produce of his *own* farming operations was distributed. This is an important factual circumstance, and one which has played a considerable role in subsequent cases, as will be shown below.

Finally, it has been noted that this case must be read in light of the well-known *dictum* in *Ernst's* case, namely that the concessions available to farmers under the Act place them in a privileged position as a class, and the relevant provisions must thus be strictly interpreted.<sup>196</sup> As the latter case was decided in the context of the Act, it is submitted that any proposed application of the principles set out in *Bryant's* case (and other cases discussed below which do not deal with tax disputes) in a fiscal context should adhere to this general principle.

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<sup>194</sup> *Bryant* (note 184 above) 212.

<sup>195</sup> *Ibid.*

<sup>196</sup> *Ernst* (Note 67 above) 343; *Williams Cases and Materials* (note 26 above) 533.

#### 4.3. EMPLOYEES DISTRIBUTING FARMING PRODUCE FROM OTHER SOURCES IN ADDITION TO THE FARMER'S OWN PRODUCE

The next case to consider a scenario comparable to that of *Bryant's* resulted in an adverse outcome for the farmer, mainly due to some material factual differences. In the case of *Giesken*,<sup>197</sup> the then Appellate Division once again considered the activities of a dairy farmer that ostensibly went beyond mere 'farming operations'.

In this instance, the Court was again not burdened with the intricacies of fiscal legislation, but fortunately, as in *Bryant's* case, the principles set out herein are equally useful in interpreting similar wording currently employed in the Act. In this case, the appellants were convicted in the Magistrate's Court of contravening the provisions of an arbitration award pertaining to a wage dispute, as well as certain 'War Measure' regulations dealing with wages of individuals employed in the 'dairy trade'.<sup>198</sup> The Transvaal Provincial Division found against the ill-fated appellants on their first appeal against the conviction,<sup>199</sup> and the Appellate Division was thus their last resort to have the conviction overturned. The issue to be decided by the Appellate Division was whether the appellants were bound by the arbitration award and regulations, which would apparently have imposed undesirable obligations on the appellants. The appellants would, however, be exempt from the arbitration award and regulations if they could prove that certain of their employees' activities constituted 'farming operations.'

Many of the facts of this case are akin to those of *Bryant's*. In particular, the appellants similarly carried on dairy farming operations on a large scale, and crucially, employed their labourers in activities going beyond ordinary farming tasks to also include the handling, selling and distribution of milk.<sup>200</sup> The Court was ultimately faced with the question as to whether the latter distribution activities fell within the ambit of the appellants' 'farming operations.'<sup>201</sup> The Court relied on the correctness of *Bryant's* case and the principles set out therein (discussed in 4.2 above), to assist it in reaching its conclusion.

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<sup>197</sup> *Rex v Giesken and Giesken* [1947] 4 All SA 343 (A).

<sup>198</sup> *Rex v Giesken and Another* 1947 (1) SA 418 (T) at 419, where it is noted that the definition of 'dairy trade' in the arbitration award included the 'sale and / or distribution of ... milk', but excluded 'farming operations' from its ambit.

<sup>199</sup> *Ibid*, 419.

<sup>200</sup> *Rex v Giesken and Giesken* (note 197 above) 345 – 346.

<sup>201</sup> *Ibid*, 345.



Intriguingly, there was a material difference between the facts of this case and that of *Bryant's*, which was ultimately decisive in the dismissal of the present appeal. This distinguishing feature was that the employees were not selling and distributing milk solely produced by the appellants' *own* farming operations. Instead, the appellants also purchased large amounts of milk from outside sources on a daily basis, mixed it with their own produce of milk and sold the mixture in containers, without any way of identifying whether the contents were produced by them or bought from outside sources.<sup>202</sup>

In setting out its reasoning in an admirably concise judgment, the Appellate Division firstly agreed with the principle that the character of a trade is defined by the nature of the enterprise undertaken for a common purpose by the employer and his employees, and that once this has been identified, all the employees are engaged in that trade, regardless of their individual activities.<sup>203</sup> Tellingly, however, the Court went a step further and held that an employer and his employees collectively can be engaged in more than one separate enterprise, of which farming may be one, provided the appropriate facts are present.<sup>204</sup> This logical extension of the abovementioned 'common purpose' principle lead the Court to reach its decisive finding, namely that the appellants were engaged in two distinct trades at the same time, namely the daily purchase and resale of milk from outside sources on the one hand, and the production and sale of their own milk on the other.<sup>205</sup> This finding was based on the appropriate facts of the appellants' case, as set out above.

The final issue to be decided by the Court was whether the activities relating to the purchase and resale (i.e. distribution) of milk from outside sources could form part of the appellants' 'farming operations', in light of the arbitration award and 'War Measure' regulations. The Court answered this question in the negative, on the basis that such distribution activities could only form part of the appellants' 'farming operations' if the milk distributed is solely sourced from their *own* operations.<sup>206</sup> As the employees were required to distribute milk which was sourced from the appellants' own operations as well as from outside sources, the Court held that the arbitration award and 'War Measure' regulations were binding on the appellants, and dismissed their appeal.

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<sup>202</sup> *Rex v Giesken and Giesken* (note 197 above) 346 – 347.

<sup>203</sup> *Ibid*, 347, with reference to *Rex v Sidersky* 1928 TPD 109 and *Bryant* (note 184 above) 209.

<sup>204</sup> *Ibid*, 347.

<sup>205</sup> *Ibid*.

<sup>206</sup> *Ibid*, 348.

In the course of its judgment the Court reached the following conclusion which, it is submitted, may be applied in similar scenarios:

‘The sale or distribution of milk obtained from other sources by purchase is not a farming operation, even if milk produced by the seller is added.’<sup>207</sup>

It thus appears that the enquiry as to whether a farmer’s distribution activities are limited to his / her own produce, is a very important factor in deciding whether such activities may form part of his / her farming operations. This principle will be referred to again in chapter 5 below.

#### 4.4. OVERVIEW OF PRINCIPLES

The cases discussed in this chapter essentially considered whether the distribution of farming produce could conceivably form part of ‘farming operations’. This question may be answered in the affirmative, as in *Bryant’s* case, provided the necessary facts are present, but may well be found to constitute a separate ‘trade’ or ‘enterprise’, as in the case of *Giesken*. As was shown, however, certain principles should be employed in deciding this issue, and a meticulous consideration of the relevant factual circumstances undertaken. The relevant principles may be briefly summarised as follows.

It has been held that the nature or character of a farmer’s enterprise must be considered to ascertain whether the ‘common purpose’ undertaken by that farmer and his / her employees are to carry on ‘farming operations’. If the latter enquiry is positive, the disposal and distribution of farming produce by the farmer may form part of his / her farming operations, even if the method of disposal brings the farmer into direct contact with the consumer. On the other hand, the factual circumstances may indicate that such disposal of farming produce by that farmer constitutes a separate trade apart from his / her farming operations. One example where this may potentially be the case is if the disposal is carried out from a shop at separate premises.

It has been held further that an individual may be engaged in more than one separate enterprise, of which farming may be one, and that this is a question of fact dependent on the particular circumstances. Finally, a crucial factor in deciding whether the distribution of farming produce may form part of an individual’s farming operations, is that only produce which is sourced from an individual’s own farming operations may so qualify.

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<sup>207</sup> *Rex v Giesken and Giesken* (note 197 above), 348.

The abovementioned principles may be applied in considering the question posed in this chapter, namely: where do farming operations end and other trades or activities begin? The question may be phrased more specifically as: is it possible for activities which may not, in ordinary parlance, constitute 'farming operations', to be included within its ambit, and if so, under what circumstances?

It is submitted that the principles discussed in this chapter may be applied in similar scenarios where other activities, which go beyond the ordinary scope of 'farming operations' for tax purposes, are sought to be included within its ambit. Such activities may include, for example, the distribution, treatment, storage, packaging and processing of farming produce. As will be shown, however, this may only be the case if the necessary facts are present. As noted before, the focus of this study is particularly on the possibility of 'processes of manufacture' being so included, i.e. where farming concerns also process their farming produce. Chapter 5 will shed more light on the reason for this very specific emphasis.

## **5. TAXPAYERS WHO CARRY ON 'FARMING OPERATIONS' AND 'MANUFACTURING PROCESSES' SIMULTANEOUSLY – RELEVANCE AND JUDICIAL CONSIDERATION**

### **5.1. INTRODUCTION**

The aim of this chapter is to introduce the main focus of this study, which is on taxpayers who carry on 'farming operations' and 'manufacturing processes' simultaneously. Judicial precedents will be discussed to identify further principles which may be relevant to these particular taxpayers. Before the case law is discussed, however, the reasoning behind the focus of this chapter bears mention. A brief overview of the study thus far will assist in this regard.

Firstly, as referred to in chapter 1, the farming and manufacturing industries are foundational to our society, for various economic and social reasons. There are, therefore, very strong policy justifications for advancing these industries. One such method employed by the State is through favourable fiscal treatment. In chapters 2 and 3 above, it was shown that there are provisions in the Act which are particularly beneficial to taxpayers who carry on farming operations, and other concessions which favour, to a lesser degree, taxpayers who carry on processes of manufacture. The most significant concessions applicable to these categories of taxpayer were analysed, while those of lesser import for present purposes were also briefly referred to with a view to provide a thorough overview of the legislation. Certain interpretational issues were dealt with, to aid in applying the legislation, principles and precedents to scenarios set out in the discussions to follow.

Chapter 4 laid the groundwork for this chapter by discussing a foundational query for present purposes, namely: where do farming operations cease and other trades or activities begin? Phrased more specifically, the question is: is it possible for activities which may not, in ordinary parlance, constitute 'farming operations', to be included within the ambit of that phrase, and if so, under what circumstances? This question is relevant for taxpayers who seek the fiscal concessions applicable to their 'farming operations', and thus require clarity as to which of their diverse operations may qualify as such. Two cases were discussed which offer useful guidelines in this regard. These guidelines will in turn be employed, along with others discussed in this chapter, in considering a hypothetical scenario for illustrative purposes in chapter 6.

This chapter (5) focuses specifically on taxpayers who carry on ‘farming operations’ and ‘processes of manufacture’ simultaneously, for it is a relevant modern phenomenon (as referred to in 4.1 above), and many taxpayers may potentially fit this description. This modern trend may be the result of, *inter alia*, the increased mechanisation of farming, as well as the economic benefits which may be enjoyed by farmers who use their own produce in further lucrative processes, such as manufacturing. One example of this occurrence is that of farmers who produce crops of grapes, and then use the grapes in winemaking activities. In this regard, the case of *KWV* (5.2.1 below) is of relevance, as well as the hypothetical scenario discussed in 6.2 below.

As discussed at an earlier point, these distinct activities have different concessions which may apply, and the provisions applicable to taxpayers carrying on farming operations are generally more beneficial than those applying to manufacturing processes (3.4 above). It is thus submitted that taxpayers would more likely, depending on their factual circumstances, seek to include their processes of manufacture within the ambit of their ‘farming operations.’ Practical examples from case law will be discussed in this chapter in order to illustrate this point, and to identify such relevant principles as may be applicable. During the course of this discussion, some of the principles referred to in previous chapters will be considered afresh, in light of diverse factual circumstances and judicial application. In addition, a number of principles which have not been discussed thus far will be brought to the fore.

## 5.2. CAN ‘FARMING OPERATIONS’ INCLUDE MANUFACTURING PROCESSES?

### 5.2.1. THE *KWV* CASE

The Appellate Division, as it then was, applied the principles set out by *Bryant’s* and *Giesken’s* cases (chapter 4 above) soon thereafter, in the *KWV* case.<sup>208</sup> Although the latter case did not deal with tax legislation, the Court did make certain useful findings on the extent of the farming operations of a wine farmer, as will be shown.<sup>209</sup> As noted in 5.1, wine farmers are a relevant example of taxpayers who carry on farming operations and manufacturing activities simultaneously. For this reason in particular, the principles which

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<sup>208</sup> *Ko-operatiewe Wynbouwers Vereniging van Zuid-Afrika Beperk v Industrial Council for the Building Industry and Others* [1949] 3 All SA 8 (A).

<sup>209</sup> The case dealt *inter alia* with labour legislation, specifically Act 36 of 1937.

arise from the *KWV* case are of considerable relevance. The facts of the *KWV* case are briefly discussed below.

The appellant (a co-operative agricultural company whose members were, *inter alia*, wine farmers), sought an order (which was refused by the court *a quo*) declaring that the provisions of a certain 'Building Industry Agreement'<sup>210</sup> were not binding on it. This agreement determined, *inter alia*, that all employers and their employees, who are associated for the purpose of erecting buildings and structures, would fall within the definition of a 'Building Industry'.<sup>211</sup> If the said agreement was indeed applicable, it would have placed certain undesirable obligations on such employers, the details of which do not appear from the judgment. Certain of the appellant's employees were engaged in activities including the construction of wine cellars and other structures required for its operations. The appellant did not wish to be bound by the terms of the said agreement, and thus sought the declaratory order referred to above.

The Court agreed, firstly, with the principle that a taxpayer may be engaged in two or more industries at the same time, but held further that one such an industry may be ancillary to the other. The Court found that the test in this regard is a question of degree.<sup>212</sup> One of the factors which the Court had regard to in deciding this question (although not conclusive on its own) was a comparison of the total annual disbursements made in connection with the distinct industries.<sup>213</sup> A further element which the Court took into consideration was the number of appellant's staff occupied in the said building operations.<sup>214</sup>

The final contention by the appellant was that its employees were employed in 'farming operations' (in particular, wine farming), and that these operations were thus exempt from the application of the relevant legislation.<sup>215</sup> On this point, the Court conceded firstly that the construction of storage tanks on a farm, whether by the farmer himself or by an independent contractor, may constitute 'farming operations', depending on the facts.<sup>216</sup> However, the Court found on the facts before it that this was not the case – i.e. the construction activities undertaken by the appellant's employees were not 'farming operations'. This finding was based, firstly, on the fact that the appellant was a distinct

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<sup>210</sup> Promulgated by the Minister of Labour.

<sup>211</sup> *KWV* (note 208 above) 9.

<sup>212</sup> *Ibid*, 12 – 13, with reference to *Giesken's* case (note 197 above).

<sup>213</sup> *KWV* (note 208 above) 14.

<sup>214</sup> *Ibid*.

<sup>215</sup> *Ibid*, 16.

<sup>216</sup> *Ibid*, 17.

legal person from its members, and that its activities were its own, and not those of its members.<sup>217</sup> In other words, if such construction activities are carried out by the appellant's members (who were *inter alia* wine farmers), it may well constitute 'farming operations' for their purposes, but similar activities carried out by the appellant cannot also constitute 'farming operations' merely by reason of having farmers for members. The appellant would have to prove that it, too, was in fact a wine farmer, and as will be shown below, it could not do so.

In this regard, the Court made some crucial findings (for purposes of this study) concerning the activities carried on by a wine farmer:

'A wine farmer produces grapes and converts them into wine and brandy: there is no allegation that the appellant produces any grapes ... as (the appellant) does not produce any grapes, it cannot be said that it is engaged in wine farming. Wine farming consists of a number of different operations, such as cultivation of vineyards, pruning of the grape vines, rendering the vines free from disease, gathering the crop, pressing the grapes into wine and probably delivering the finished product to the "first buyer."'<sup>218</sup> (Emphasis added for purposes of the discussion in 5.2.2 below).

The Court found further that a person who receives grapes for conversion into wine and deals with the grapes as he sees fit, is not a wine farmer. This finding was based on the principle that operations carried on by or on behalf of a farmer may be 'farming operations', but not if performed by or on behalf of a person who is not a farmer.<sup>219</sup> Accordingly, the Court held that 'the construction of wine-receiving tanks in the present case is not being performed by or on behalf of a farmer: it is being performed by a co-operative agricultural company which is *not a farmer*,' (emphasis added).<sup>220</sup> It was held further that the said construction activities were not performed '*on behalf of*' farmers either, as there was no proof that all of appellant's members were farmers (i.e. some of its members were wine societies and companies).<sup>221</sup> Accordingly, the application was dismissed, as the appellant could not disprove that it was associated with its employees for the purpose of erecting buildings and structures, nor prove that its employees were engaged in farming operations.

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<sup>217</sup> *KWV* (note 208 above) 17.

<sup>218</sup> *Ibid.*, 17 – 18.

<sup>219</sup> *Ibid.*, 18.

<sup>220</sup> *Ibid.*

<sup>221</sup> *Ibid.*

### 5.2.2. PRINCIPLES ARISING FROM *KWV*

The first relevant principle which may be gleaned from this case is that a taxpayer who carries on one trade may also prove to be carrying on one or more further trades, but this is a question of degree. Factors which may be taken into account in this regard (but should not be decisive on their own) include the aggregate expenditure on the distinct trades, as well as the number of employees respectively dedicated thereto. Further, while a taxpayer may carry on more than one distinct industry or trade (with farming being merely one of them), it may be shown that one of these trades is ancillary to the other(s). This is also a question of degree. It is submitted that all the relevant facts and circumstances should be taken into account in determining this question, including the factors referred to above.

A further important principle from this case is that a taxpayer who is a legal entity (e.g. a company), who seeks to argue that activities undertaken by it constitute ‘farming operations’, should ensure that it is its *own* activities which are referred to, and not those of its ‘members’ (e.g. shareholders). This is due to the fact that such a taxpayer is a legal person distinct from its constituent ‘members’, and that the nature of their activities cannot by implication be imputed to the taxpayer.

It was also held in this case that an activity may constitute a ‘farming operation’ when performed by or on behalf of a farmer, but will not qualify as such if performed by or on behalf of a person who is not a farmer. The Court accepted as correct the example of an independent contractor who is engaged by a farmer to plough the farmer’s fields – in that instance, the Court agreed, the contractor and his employees would be engaged in farming operations.

For purposes of this study, however, the most crucial principle arising from the *KWV* case is based on certain findings by the Court as to the nature of winemaking activities. In particular, the Court held that a wine farmer ‘produces grapes and *converts them into wine...*’ and again that wine farming includes ‘*pressing the grapes into wine ...*’.<sup>222</sup> From these *dicta*, two important conclusions may be drawn. Firstly, the emphasised text may be described, in isolation, as a ‘process of manufacture’ for tax purposes, as will be shown in 6.3 below. Secondly, the Court recognised that the aforementioned process constitutes a component of wine farming, additional to the production or cultivation of the grapes, provided it was performed by an entity engaged in farming operations.

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<sup>222</sup> The *dicta* (with emphasis added) from *KWV* (note 208 above), 17 – 18, is quoted in full in 5.2.1 above.



By implication, therefore, one may conclude that if the necessary facts are present, a 'process of manufacture' may be included within the scope of 'farming operations'. It is submitted that there is no reason why such a conclusion should be limited to wine farmers, to the exclusion of other farmers with similar factual circumstances. This is borne out by further judicial commentary on the subject and the practice of SARS,<sup>223</sup> and is of crucial significance for purposes of the hypothetical scenario postulated in 6.2.

The Court further confirmed (in the rest of the quoted portion referred to above) that the delivery or distribution of the finished product (i.e. wine) may constitute a part of wine farming, thus recognising that such activities (referred to hereinafter as 'post-farming' activities for purposes of convenience) may also fall within the ambit of 'farming operations'.<sup>224</sup> This is further confirmation of the decisions in *Bryant's* and *Giesken's* cases, which first recognised the aforementioned principle.<sup>225</sup>

The abovementioned *ratio* in the *KWV* case is of particular relevance as it confirms that a 'process of manufacture' may be included within the ambit of 'farming operations.' Such post-farming activities, especially processes of manufacture, it is submitted, should nonetheless be limited to the use of the taxpayer's *own* produce, and not include produce from outside sources.<sup>226</sup>

### 5.2.3. APPLICATION AND DEVELOPMENT OF PRINCIPLES FROM *KWV*

The principles crystallised in the *KWV* case were applied shortly thereafter by the Cape Provincial Division in the *Porterville Ko-op* case.<sup>227</sup> The Court in that case dealt with a similar scenario, finding that activities carried out by an agricultural co-operative on behalf of its farmer members were not 'farming operations' (i.e. 'boerderybedrywighede', in Afrikaans), as the co-operative was not itself engaged in farming.<sup>228</sup>

The Court held, firstly, that the phrase 'farming operations' describes work done on a farm with the intention to bring forth produce, but that it can also have a 'wider meaning,' which

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<sup>223</sup> 5.2.3 – 5.3 below.

<sup>224</sup> *KWV* (note 208 above) 17 – 18.

<sup>225</sup> Discussed in 4.2 and 4.3 above.

<sup>226</sup> This principle arises from the *Bryant* and *Giesken* cases (4.2 and 4.3 above). It is submitted that this suggestion accords with the strict approach to the interpretation of farming concessions, as per *Ernst's* case (note 196 above).

<sup>227</sup> *Rex v Porterville Ko-op Landbou Mpy Bpk* [1952] 1 All SA 278 (C). This case did not deal with fiscal legislation, but with a charge of the contravention of Act 30 of 1928. The meaning of the phrase 'farming operations' ('boerderybedrywighede') was considered in this case, however, which is why it is of relevance.

<sup>228</sup> *Ibid*, 280.

includes the *production or selling* of farming produce (i.e. post-farming work) by a farmer or his employees, as long as the produce arose from the farmer's own operations.<sup>229</sup> The Court found that this wider meaning is not wide enough, however, to include situations where post-farming work is done in relation to farming produce by persons other than the farmer himself.<sup>230</sup> In the Court's view, the difference lay therein that persons who carry out such post-farming work in the former scenario are producing 'from and out of a farm' (my translation of the Afrikaans), whereas in the latter case they are not.<sup>231</sup>

It is submitted that this finding is not inconsistent with that of the Appellate Division in the *KWV* case, namely that operations carried on by or on behalf of a farmer may be farming operations, but not if performed by or on behalf of a person who is not a farmer.<sup>232</sup> The point made in *Porterville's* case is that the inclusion of *post-farming* work within the ambit of a taxpayer's farming operations is only justifiable if such work is carried out by the producer (i.e. the farmer) himself, while the quoted *dictum* from *KWV*, on the other hand, refers to activities which are manifestly still part of normal farming operations. This submission is borne out, firstly, by the fact that the activities which the appellant in *KWV* sought to include within the ambit of its farming operations were not *post-farming* activities. The difficulty for the appellant was rather that they were not its own farming activities. In addition, the Court held in *KWV* that a person who receives produce (i.e. from the producer) for conversion into a final product, and then deals with the produce as he sees fit, is not carrying on farming operations.<sup>233</sup> The principle from *Porterville* referred to above is thus that post-farming activities can only be included within a taxpayer's farming operations if the produce arose from *his own* operations.

In reaching its verdict, the Court in *Porterville's* case relied on the judgments of *Bryant*, *Giesken* and *KWV*, as is apparent from the above.<sup>234</sup> It is submitted that *Porterville's* case thus provides further evidence of judicial willingness to include post-farming work in relation to farming produce (which may include processes of manufacture) within the phrase 'farming operations', if the necessary factual circumstances are present. In other words, a 'wider meaning' may be applied to that phrase (subject to the limitation discussed

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<sup>229</sup> *Porterville* (note 227 above) 280 – further confirmation of the findings in *Bryant* and *Giesken* (4.2 and 4.3 above).

<sup>230</sup> *Ibid.*

<sup>231</sup> *Ibid.*

<sup>232</sup> *KWV* (note 208 above) 17 – 18.

<sup>233</sup> *Ibid.*, 18.

<sup>234</sup> *Porterville* (note 227 above) 280 – 281; Refer also to the discussions in 4.2, 4.3 and 5.2.1 above regarding the abovementioned cases.

above). It is the application of this 'wider meaning' which is of considerable importance for purposes of this chapter and chapter 6 below.

A further instance of judicial application of the principles set out in *KWV* and the preceding cases referred to above is that of *Ambleside Tobacco*,<sup>235</sup> a case decided by the High Court of the erstwhile Southern Rhodesia (now Zimbabwe). While this case was decided under the laws of a neighbouring country, it is submitted that the application by that Court of the principles set out in the cases of *Bryant*, *Giesken* and *KWV* is nonetheless of persuasive value.<sup>236</sup> This is even more so as consideration was given to a factual scenario with similarities to the aforementioned South African cases.

In the *Ambleside Tobacco* case, the Court considered whether the plaintiffs, who carried on business as tobacco graders, were engaged in 'farming operations'. The Court agreed with the premise that certain activities carried on by a farmer subsequent to his 'basic processes of growing and reaping of crops or raising of stock...' may be regarded as 'incidental to the activities or undertaking of a farmer.' The Court found further that 'the grading by a tobacco farmer is (no) less *incidental* to him as being a farming operation as was the selling and delivery of the milk produced by the dairy farmer in *Bryant's* case.'<sup>237</sup> (Emphasis added in both instances). The emphasised word in the quoted passages indicates an interesting interpretation of the principle in *Bryant's* case, namely that the post-farming activities of a farmer should be incidental to (i.e. subsidiary or supplementary to)<sup>238</sup> his farming operations, in order to constitute a part thereof. This approach, it is submitted, is a further useful guideline.

Ultimately, the Court concluded that, as the plaintiffs were not themselves tobacco farmers and their activities were limited to tobacco grading, they were not engaged in farming operations.<sup>239</sup> The Court reconciled this finding with the principle that the nature of the enterprise in which an employer and its employees are associated for a common purpose must be considered, and not the 'special nature' of the work carried out by the employees.<sup>240</sup> The Court held that the latter principle applies to the relationship between the plaintiffs and the farmers on whose behalf they conduct the tobacco grading, so that the

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<sup>235</sup> *Ambleside Tobacco Grading Co (Pvt) Ltd v Abrahamson*, NO 1959 (1) SA (SR).

<sup>236</sup> *Ibid*, 3 – 4.

<sup>237</sup> *Ibid*, 3, with reference to the decision in *Bryant's* case (4.2 above).

<sup>238</sup> S Hawker *The Little Oxford Dictionary & Thesaurus* (1998) 250.

<sup>239</sup> *Ambleside Tobacco* (note 235 above) 4.

<sup>240</sup> *Ibid*, with reference to *Rex v Sidersky* (note 203 above); refer also to the discussion in 4.3 (and note 203 above).

plaintiffs (as independent contractors) and the farmers are jointly associated in farming operations as a common purpose.<sup>241</sup> This did not mean, however, that the common purpose of the plaintiffs and *their* employees constituted farming operations, in the Court's judgment (seeing as the plaintiffs were not farmers themselves), even though the services rendered by the plaintiffs to the farmers were incidental to the farmers' operations.<sup>242</sup> This latter finding, it is submitted, confirms the soundness of the limitation placed on the 'wider meaning' to 'farming operations' as per the *Porterville* case; i.e. even though the tobacco grading was carried out on behalf of farmers, such post-farming activities were carried out by the plaintiffs who did not produce the tobacco themselves by farming, and the 'wider meaning' could thus not apply.

While the Court did not consider whether tobacco grading was a process of manufacture, it is submitted that this case (in dealing with post-farming activities pertaining to farming produce) nonetheless provides further useful guidelines for purposes of this chapter.

#### 5.2.4. THE *BEHR* CASE

Not long after the cases discussed above were decided, the Cape Provincial Division heard an appeal from an individual who carried on farming operations (the cultivation of trees for timber) but also operated a saw-mill on his farm.<sup>243</sup> The appellant was charged and convicted by a Magistrate's Court with the contravention of certain legislative provisions in terms of which he was alleged to have wrongfully and unlawfully operated a factory without a registration certificate.<sup>244</sup> The appellant appealed against the conviction.

While this case thus did not deal with fiscal legislation, the Court did consider the question whether the appellant's saw-milling activities (a process of manufacture, as will be shown below) were performed by him *solely in connection with* his farming operations.<sup>245</sup> Although the latter emphasised wording is not used in section 26(1) of the Act, it is submitted that the issue in this case, which is essentially whether the appellant's manufacturing activities were inextricably linked to his 'farming operations', corresponds with the central theme of this chapter.

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<sup>241</sup> *Ambleside Tobacco* (note 235 above) 4.

<sup>242</sup> *Ibid*, with reference to the *KWV* case (note 208 above) 18.

<sup>243</sup> *S v Behr* 1962 (3) SA 109 (C).

<sup>244</sup> As per the erstwhile Factories, Machinery and Building Work Act, 22 of 1941.

<sup>245</sup> *S v Behr* (note 243 above) 111.

The definition of ‘factory’ under the applicable legislation was crucial in this case. This definition excluded from its ambit such premises ‘on which a farmer ... performs work ... solely in connection with products which he has produced on a farm occupied by him, or solely in connection with his farming operations.’<sup>246</sup> The appellant argued that this exclusion applied to his saw-mill (i.e. it was not a ‘factory’, as defined), as he was a farmer whose work on those premises ‘included the sawing and processing of timber for sale in the form of box-wood,’ but that such activities were carried out solely in connection with his farming operations.<sup>247</sup>

Before discussing the Court’s judgment, some preliminary remarks regarding the above process are appropriate. While the definition of a ‘factory’ was considered in *Behr’s* case under separate legislation, it is submitted that saw-milling activities such as the appellant’s would constitute a ‘process of manufacture’ under the Act, based on the following reasoning. The saw-milling activities (as described in the case) were a ‘process’<sup>248</sup> by which raw timber is converted into finished products (fruit box components), which are ‘essentially different’ to the constituent raw materials (unprocessed timber), *inter alia* as regards physical attributes (box components have shapes and dimensions not possessed by raw timber), utility (the components may be assembled for use in packaging; raw timber cannot), and potential saleability as a completely different commodity.<sup>249</sup> In addition, Practice Note 42 includes the ‘felling, trimming, debarking and cutting into specified lengths of forest produce (excluding farmers)’ as a ‘Process of Manufacture.’<sup>250</sup>

This case is relevant, therefore, because it dealt in essence with a farmer seeking to include a ‘process of manufacture’ within the ambit of his ‘farming operations’, even though this was in the context of non-fiscal legislation with very specific requirements. In other words, the appellant basically sought to attach a ‘wider meaning’ to the phrase ‘farming operations’, as was discussed in the *KWV* case (see 5.2.3 above) – and for this reason *Behr’s* case invites close scrutiny in the present context.

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<sup>246</sup> *S v Behr* (note 243 above) 111.

<sup>247</sup> *Ibid.*

<sup>248</sup> The activities described above arguably entail a ‘series of actions or steps taken in order to achieve a particular end’ – the end being the fabrication of fruit boxes; see 3.2.4 above.

<sup>249</sup> Refer to 3.2.4 above for a discussion, with reference to case law, of the phrase ‘process of manufacture’.

<sup>250</sup> In particular Annexure B thereof (note 125 above). Even though the Practice Note specifically excludes farmers as regards such activities, it is referred to here simply to strengthen the submission that the appellant’s saw-milling activities, viewed in isolation, constituted a ‘process of manufacture.’

In its judgment, the Court accepted, firstly, that the appellant's 'farming activities' consisted of the 'planting of trees ... and *the sale of timber*.'<sup>251</sup> (Emphasis added). The Court's view that the sale of farming produce could also constitute 'farming activities,' corresponds with case law on this point.<sup>252</sup> The Court found further that the saw-milling operation was the kind of activity referred to in the abovementioned definition of 'factory', and thus it remained to consider whether either of the exclusions from that definition in the applicable legislation was applicable. Firstly, as the appellant not only used his own timber in the mill, but also timber from outside sources, the Court found that he did not use the mill 'solely in connection with products which he has produced on a farm occupied by him.' The appellant's saw-mill could thus only have been excluded from the definition of a 'factory' if it was used *solely in connection with his farming operations* (i.e. in terms of the second exclusion), but the Court found against the appellant in this regard too.<sup>253</sup> In the Court's view, the legislative intention with the second exclusion (emphasised above), was to extend the said exemption to manufacturing activities using products from outside sources, but only if such activities are performed solely in connection with the individual's own farming operations.<sup>254</sup>

A caveat should be noted in this regard, however, with reference to *Giesken's* case and the subsequent judicial application thereof.<sup>255</sup> In particular, the phrase 'farming operations' has been held *not* to include post-farming work by a farmer using produce from an outside source. It should be noted that in *Behr's* case, however, the Court's view of the legislative intent was strictly in the context of the very specific enactment considered. In spite of this qualification, however, it is submitted that the Court's findings in this case are nonetheless of use. The Court ultimately found against the appellant, holding that the saw-mill was *not an integral part of his farming operations without an independent existence*, and was thus not used solely in connection with his farming operations.<sup>256</sup> It is the emphasised portion of the latter finding which, it is submitted, is of relevance for purposes of this chapter, based on the following reasoning.

Taxpayers seeking to draw a process of manufacture undertaken by them into the ambit of their farming operations might further bolster their argument if it can be shown that the

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<sup>251</sup> *S v Behr* (note 243 above) 110.

<sup>252</sup> As discussed in 4.2, 4.3 and 5.2.1 above.

<sup>253</sup> *S v Behr* (note 243 above) 112.

<sup>254</sup> *Ibid*, 111 – 112.

<sup>255</sup> Refer to the discussions in 4.3 and 5.2.1 above.

<sup>256</sup> *S v Behr* (note 243 above) 112.

process is an *integral part* of their farming operations, *without an independent existence*. This might be the case, for example, if a taxpayer grows crops of fruit and simultaneously operates a plant where only his own fruit is converted into processed products, such as jam or preserves. The taxpayer could thus argue that the plant is the concluding step of his farming operations (i.e. it is an integral part thereof), and it is strictly intended and used for the processing of his own farming produce (i.e. it has no independent existence, in an operational sense, from his farming operations). The aforementioned factors could thus support an argument that the said manufacturing process is not a separate trade for tax purposes, but should be included within the taxpayer's farming operations.

As the Courts apply a strict approach to the concessions available to farmers as a privileged class,<sup>257</sup> it is submitted that such taxpayers may benefit from applying this principle from *Behr's* case – which sets a high threshold for so extending the privilege. This principle might thus be a further element of a persuasive argument, as referred to above.

### 5.3. PRACTICE OF THE SOUTH AFRICAN REVENUE SERVICE

It appears that SARS, in practice, will regard taxpayers who use their *own* farming produce in a process of manufacture (for example, in winemaking or the processing and canning of fruit) as carrying on only 'farming operations', i.e. even in respect of that manufacturing process.<sup>258</sup> However, if the same taxpayer uses produce from outside sources to a material extent in his / her process of manufacture, SARS is likely to regard the taxpayer as carrying on two distinct trades (i.e. farming and manufacturing).<sup>259</sup>

Firstly, it should be noted that the departmental 'practices' of SARS, in terms of which it assesses taxpayers, do not have the force of law,<sup>260</sup> but the Act nonetheless precludes the Commissioner from raising an additional assessment if an amount was not assessed to tax due to a 'practice generally prevailing' at the date of the assessment.<sup>261</sup> A general caveat should be borne in mind, however, namely that a particular interpretation of a provision of the Act will not necessarily be upheld by the Court, even if that construction has been followed for a considerable period of time by SARS and a lower Court, if that

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<sup>257</sup> *Ernst's* case (note 67 above) 343.

<sup>258</sup> *De Koker Silke* (note 11 above) 15.32.

<sup>259</sup> *Ibid.*

<sup>260</sup> *Williams Law and Practice* (note 12 above) 16.

<sup>261</sup> Section 79(1) proviso (iii).

interpretation is not supported by the clear words of the particular provision.<sup>262</sup> Accordingly it is submitted that the abovementioned practice of SARS should not be relied upon by taxpayers in isolation, without due consideration of all relevant facts and principles as set out in this chapter and chapter 4 above.

Moreover, it has been noted that difficulties may arise if SARS were to regard a farmer who uses his produce in carrying on a process of manufacture, as being engaged in two distinct trades.<sup>263</sup> In particular, it may be difficult to ascertain the farmer's taxable income from his farming operations, as neither the Act nor the First Schedule provides for the apportionment of income between two such distinct trades.<sup>264</sup> It would therefore be preferable, not only insofar as the favourable farming concessions are concerned, but also from a compliance point of view, for a taxpayer's process of manufacture to be regarded as part of his farming operations, if the facts so permit.

A possible solution has been suggested which may assist a taxpayer to justify the latter approach, and so to avoid the difficulties posed by viewing his farming operations and manufacturing processes as two distinct trades. This solution suggests a review of the facts in order to ascertain which of the two trades may be regarded as the taxpayer's main trade, and then regarding the income from both distinct trades as arising from the main trade.<sup>265</sup> It is submitted that this approach may be justifiable in light of the Court's findings in the *KWV* case (see 5.2.1 above), namely that a taxpayer who carries on two distinct trades may argue that the one trade is ancillary to the other. As noted, however, this is a question of degree, and account may thus be taken of the factors noted as relevant by the Court in that case, including the respective aggregate expenditure and number of employees dedicated to the distinct trades.<sup>266</sup>

#### 5.4. OVERVIEW OF PRINCIPLES

Chapter 4 introduced the premise that certain activities (such as distribution) may be included within the ambit of 'farming operations', even though they may not be so regarded in ordinary parlance. This chapter elaborated on that premise by arguing that, under certain circumstances, taxpayers who carry on farming operations and processes of

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<sup>262</sup> *Ernst's case* (note 67 above) 344.

<sup>263</sup> *Meyerowitz* (note 44 above) 20.8.

<sup>264</sup> *Ibid.*

<sup>265</sup> *Ibid.*

<sup>266</sup> *KWV* (note 208 above) 12 – 14; with reference to *Giesken's case* (note 197 above).



manufacture simultaneously may regard the latter processes as forming part of their farming operations. Chapter 6 will apply these principles to a postulated practical example, and illustrate how such guidelines may have beneficial results from a tax perspective. Before the next chapter is introduced, however, a brief summary of the relevant principles discussed in this chapter follows below.

Firstly, taxpayers who carry on more than one trade simultaneously (with farming being one), may aver that one of their trades is ancillary to the other(s), with relevant factors such as the expenditure and number of employees respectively dedicated thereto. Taxpayers who are legal entities, seeking to make such averments regarding their operations should, however, ensure that it is their own operations which are considered, and not those of their members. A principle which follows from the latter is that activities may constitute farming operations if carried on by or on behalf of a farmer, but will not qualify as such if performed by or on behalf of a person who is not a farmer. In addition, certain findings of the Appellate Division with respect to wine farmers<sup>267</sup> support the submission that a 'process of manufacture' may be included within the scope of 'farming operations,' provided the taxpayer's factual circumstances justify such a finding. The latter point is confirmed by judicial recognition that a 'wider meaning' may be attached to the phrase 'farming operations,' so that it may include the *processing or selling* of farming produce, as long as such post-farming work is carried on by the farmer himself.

A further principle which arose from case law is that post-farming activities should be incidental to (i.e. subsidiary or supplementary to) a taxpayer's farming operations to be potentially included within the ambit of such operations. An argument for the inclusion of a manufacturing process within the scope of a taxpayer's farming operations may also be augmented if such a post-farming process is an integral part of the taxpayer's farming operations, without an independent existence.

Finally, it has been noted that SARS may in practice support such an argument, but that close regard will nonetheless be had to the taxpayer's factual circumstances (such as whether the taxpayer uses only produce from his own farming operations). However, seeing as SARS' practices are not binding in law, nor will they be upheld by the Courts if considered to be contrary to unambiguous wording of the Act, it is submitted that taxpayers should not rely on the abovementioned practice without putting forth a well-considered argument.

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<sup>267</sup> *KWV* (note 208 above) 17 – 18.

The aim of this study is thus to identify, as far as possible, general principles which may be of assistance to taxpayers seeking to formulate a convincing argument. It should be noted, however, that no single guideline is likely to suffice if applied on its own, especially in light of the strict approach to the concessions available to farmers as a privileged class. It is therefore submitted that a carefully constructed argument should apply as many of the said guidelines as are applicable to the taxpayer's facts, so as to ensure the highest possible likelihood of success.

The following chapter aims to formulate, for illustrative purposes, an argument for the inclusion of a 'process of manufacture' within the scope of a taxpayer's 'farming operations,' with the aid of a hypothetical scenario. It should be noted, however, that while the hypothetical scenario postulates a taxpayer farmer who carries on wine farming activities, there are other examples of taxpayers who similarly carry on both manufacturing processes and farming operations. Such examples include cattle farmers who operate abattoirs, maize or wheat farmers who carry out milling operations, and fruit farmers who carry out canning processes.

## **6. APPLICATION OF PRINCIPLES TO HYPOTHETICAL SCENARIO**

### **6.1. INTRODUCTION**

The preceding chapters (4 and 5) set out various principles with reference to judicial commentaries and the literature. These principles may be useful to taxpayers who carry out farming operations and a process of manufacture simultaneously, and seek to apply farming concessions to the latter process for tax purposes. It is submitted, however, that the relevance of these principles may be best illustrated with the aid of a practical example.

Accordingly, the hypothetical scenario set out in this chapter could serve as a basis for the practical application of the abovementioned principles, and in formulating an argument in favour of the beneficial fiscal treatment sought by the postulated taxpayer. Thereafter, the relevant concessions which may apply to his operations are referred to, with submissions as to why the particular concessions may be beneficial to the said taxpayer.

### **6.2. HYPOTHETICAL SCENARIO**

The scenario which is considered in this chapter is that of a farmer (the Taxpayer) who plants, cultivates and harvests grapes on his own wine farm. A certain portion of such produce is sold in bulk, unprocessed, for human consumption in the form of fresh grapes – but only the farmer's own produce is so distributed. The Taxpayer applies various tax concessions available to farmers in terms of section 26(1) and the First Schedule to the aforementioned farming operations, but this part of his activities will not be considered in great detail. The main focus of this chapter pertains to the operations described below.

The remaining portion of the Taxpayer's crop of grapes is used concurrently by him in an integrated winemaking operation, including all pressing, fermentation, maturation, bottling, labelling and packaging processes, through which a finished product (i.e. bottled and labelled estate wine) is ultimately created, then sold and distributed by the Taxpayer. No raw materials (i.e. harvested grapes) are acquired from outside sources for use by the Taxpayer in the said winemaking operations. The Taxpayer employs various assets in the course of his winemaking operations, including specialised equipment such as pumps, tanks and barrels, bottling, labelling and packaging equipment, and buildings such as storerooms, cellars, and a bottling and packaging facility. The Taxpayer has incurred

expenses (and continues to do so) in respect of all of the aforementioned assets, and seeks relief for tax purposes, if possible.

The Taxpayer is considering the application of certain farming tax concessions to his winemaking operations that, if possible, will be more beneficial to him for tax purposes than the relevant manufacturing provisions. However, in order to justify the application of such farming concessions to his winemaking operations, the Taxpayer seeks to formulate a cogent argument. The suggested elements of such an argument are discussed under the heading immediately below. Thereafter (in 6.4), the relevant concessions which may apply to the Taxpayer's winemaking activities, should the argument in favour of such treatment be successful, are discussed.

### 6.3. FORMULATING THE ARGUMENT: APPLICATION OF LEGISLATION AND PRINCIPLES

On close scrutiny of the hypothetical scenario posited above, the Taxpayer could argue that the income from his winemaking activities is, in fact, derived from 'other farming operations', as envisaged in section 26(1).<sup>268</sup> If the Taxpayer can formulate a convincing argument in this regard, the taxable income derived from his winemaking activities should fall to be 'determined in accordance with the provisions of the Act but subject to the provisions of the First Schedule.'<sup>269</sup> This would thus enable him to justify the application of certain favourable provisions of the First Schedule in respect of such winemaking operations, where relevant.

Firstly, the Taxpayer's farming activities involve 'agricultural' operations, i.e. 'the production of produce from a land-based economy'.<sup>270</sup> It is further clear that the Taxpayer himself is 'carrying on' such operations, as he is engaged in an activity in the nature of farming, and evidently possesses a genuine intention to carry on farming operations profitably.<sup>271</sup> It is thus submitted that the income derived from the Taxpayer's cultivation of grapes should be dealt with in terms of section 26(1) and the First Schedule. In addition, the Taxpayer's sale and distribution of his farming produce (i.e. fresh grapes) arising from the latter agricultural activities, may arguably be included within the ambit of his farming

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<sup>268</sup> 2.2.3 above.

<sup>269</sup> Section 26(1).

<sup>270</sup> *ITC 1373* (note 36 above) 194.

<sup>271</sup> *Smith* (note 22 above) 13.

operations, as he is distributing only his own produce.<sup>272</sup> Based on the latter factor, the said distribution activities do not constitute a separate trade, but rather form part of the 'enterprise undertaken for a common purpose' by the Taxpayer, namely the carrying on of 'farming operations'.<sup>273</sup> It is thus submitted that the income derived by the taxpayer from these activities should also fall to be dealt with in terms of section 26(1) and the First Schedule. It is thus evident that certain 'post-farming' activities of the Taxpayer may, on the basis of principles arising from case law and commentaries, be included within the ambit of his farming operations.

As for the Taxpayer's winemaking operations, the following comments apply. It should be noted, firstly, that the process of winemaking (in isolation) constitutes a 'process of manufacture' within the context of the Act and as interpreted through judicial commentaries and the literature.<sup>274</sup> This submission is based on the following reasoning. Winemaking, or 'pressing grapes into wine,'<sup>275</sup> logically entails the conversion of raw material (grapes) by a 'process'<sup>276</sup> into a finished product (wine), which is an 'essentially different' substance to its constituent raw materials, *inter alia* as regards its physical attributes (being a liquid, as opposed to a solid), chemical make-up (for example, it contains alcohol whereas unfermented, fresh grapes do not), utility (it may be consumed by drinking, whereas grapes – in solid form – cannot) and its potential saleability as a completely different commodity with a (potentially) much higher value.<sup>277</sup> Not only is the Taxpayer's winemaking process thus a post-farming process (in other words, carried out by using produce from his farming operations),<sup>278</sup> but also a very specific type of post-farming process – namely one in respect of which certain concessions may be applicable under the Act. The question thus arises as to which concessions, if any, should apply to the said winemaking activities. Should the Taxpayer accept that the less favourable manufacturing concessions should apply thereto, or should he seek to draw the latter process within the ambit of his farming operations, so as to justify the application of concessions available to farmers in terms of section 26(1) and the First Schedule? As

<sup>272</sup> *Rex v Giesken and Giesken* (note 197 above) 348; 4.3 above.

<sup>273</sup> *Ibid.*

<sup>274</sup> *KVV* (note 208 above) 17 – 18; and the discussion in 5.2.1 above.

<sup>275</sup> *Ibid.*

<sup>276</sup> Wine pressing is a 'process', i.e. a 'series of actions or steps taken in order to achieve a particular end' – the end being the production of wine; see 3.2.4 above.

<sup>277</sup> Refer to 3.2.4 above for a discussion, with reference to case law, of the phrase 'process of manufacture'.

<sup>278</sup> 5.2.2 above.

previously analysed, and summarised in 6.4 below, the latter option is clearly more favourable for the Taxpayer from a tax point of view.

The argument in favour of including the winemaking process as a part of the Taxpayer's farming operations is as follows. The Taxpayer may argue, firstly, that his winemaking activities form part of his common purpose of carrying on 'other farming operations', in the context of section 26(1).<sup>279</sup> In so doing, the Taxpayer should recognise that the latter general phrase widens the ambit of and takes its meaning from the context of the foregoing specific phrases (i.e. 'pastoral' and 'agricultural').<sup>280</sup> The Taxpayer thus argues that the phrase 'other farming operations' includes his winemaking activities, for the latter process is concerned with and related to the primary production of produce from a land-based economy.<sup>281</sup>

In expanding on the point made above, the Taxpayer may argue that his winemaking process does not constitute a separate enterprise or trade, but that it is rather an ancillary activity to his farming operations.<sup>282</sup> As this is a question of degree, the Taxpayer may highlight any relevant factors which may verify this contention, based on his factual circumstances.<sup>283</sup> For instance, he may emphasise the fact that it is only his own farming produce which is being used in his winemaking process, and that none of the farming produce so used is acquired from outside sources.<sup>284</sup> In addition, the Taxpayer may argue, if this can be verified on the facts, that his total annual disbursements on the winemaking process, as well as the number of employees dedicated thereto, does not overshadow the resources committed to his strictly 'agricultural' operations (i.e. the planting, cultivation and harvesting of grapes).<sup>285</sup> A further factor which may justify the abovementioned submission is that the Taxpayer is a natural person who conducts his own farming operations, and does not conduct such operations on behalf of other farmers.<sup>286</sup> It may be argued that this is apparent if regard is had to the Taxpayer's activities pertaining to the cultivation of grapes – i.e. his 'agricultural' operations as discussed above. The Taxpayer

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<sup>279</sup> 4.2 above.

<sup>280</sup> *Kellaway* (note 42 above) 148, with reference to Du Plessis *The Interpretation of Statutes* (1986) 154; 2.2.3 above.

<sup>281</sup> *ITC 1373* (note 36 above) 193; 2.2.3 above.

<sup>282</sup> *KWV* (note 208 above) 12, with reference to *Giesken's* case (note 197 above); 5.2.1 above.

<sup>283</sup> *Ibid.*

<sup>284</sup> *Rex v Giesken and Giesken* (note 197 above) 348; 4.3 above.

<sup>285</sup> *KWV* (note 208 above) 14; 5.2.1 above.

<sup>286</sup> *Ibid* (*KWV*) 17. In other words, the Taxpayer does not conduct winemaking on behalf of other persons (who may or may not be carrying on farming operations themselves), nor is he seeking to include any other taxpayer's activities besides his *own* winemaking process within the ambit of his farming operations.

thus basically seeks the attribution of a wider meaning to the phrase 'other farming operations' in section 26(1), so as to include his winemaking process therein.<sup>287</sup> The fact that he processes his own farming produce is an important indication that he does not thereby over-extend the said wider meaning.<sup>288</sup> The Taxpayer may ultimately argue, in light of the various factors discussed above, that his winemaking process is incidental to (i.e. subsidiary or supplementary to) his farming operations,<sup>289</sup> which should further justify the inclusion thereof within the ambit of his farming operations.

A further element which may be incorporated by the Taxpayer into his argument is the submission that his winemaking process is an integral part of his farming operations without an independent existence.<sup>290</sup> The Taxpayer may substantiate this submission by arguing that his winemaking process is the concluding step of his farming operations and would not have been carried out apart from his farming operations, as he uses only his own produce in that process. Such a submission lends further support to the argument that the Taxpayer's winemaking process is not a separate trade for tax purposes, but should be included within his farming operations.<sup>291</sup>

Finally, the Taxpayer may argue that the current practice of SARS seems to support the view that his manufacturing process (his winemaking activities) is merely a part of his 'farming operations' for purposes of section 26(1) and the First Schedule, and that the applicable farming concessions should thus be available to that process as well.<sup>292</sup> This averment should be based on all of the abovementioned factors, with special emphasis on the factor that the Taxpayer only uses produce arising from his own farming operations in the said manufacturing process. In relying on this practice, however, the Taxpayer should take note of the caveats set out in 5.3 above in respect of reliance on the practice of SARS.

The argument above, based on the facts in the postulated scenario and the guidelines provided by case law, does not purport to provide a comprehensive list of all the relevant factors which may be taken into account by other taxpayers in a similar position to that of the hypothetical Taxpayer. The foregoing rather serves as an example of the type of principles and factors which may be taken into account in similar instances. The final

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<sup>287</sup> *Porterville* (note 227 above) 280; 5.2.3 above.

<sup>288</sup> *Ibid.*

<sup>289</sup> *Ambleside Tobacco* (note 235 above) 3; 5.2.3 above.

<sup>290</sup> *S v Behr* (note 243 above) 112; 5.2.4.

<sup>291</sup> *Ibid.*

<sup>292</sup> 5.3 above.

portion of this chapter briefly discusses the relevant concessions which may be applicable to the Taxpayer's activities.

#### 6.4. CONSIDERATION OF POTENTIALLY APPLICABLE CONCESSIONS

The discussion to follow assumes that the Taxpayer's argument above, based on the facts of the hypothetical scenario, will be successful – i.e. it is postulated that SARS will agree that the Taxpayer's winemaking activities (strictly speaking, a 'process of manufacture') form part of his 'farming operations.'

The first consequence of the successful argument is that the taxable income derived by the Taxpayer from the carrying on of his winemaking activities fall to be determined in accordance with the provisions of the Act, but subject to the provisions of the First Schedule.<sup>293</sup> In other words, the favourable concessions and other relevant provisions of the First Schedule may apply to such process, in spite of the fact that it also constitutes a process of manufacture. The discussion to follow will only briefly refer to the most relevant concessions which may be available to the Taxpayer in respect of his winemaking activities. A more detailed overview of the relevant legislative provisions has already been provided earlier in this study.<sup>294</sup>

Firstly, it is submitted that the buildings used by the Taxpayer in his winemaking process (e.g. storerooms, cellars, bottling and packaging facilities) form part of his income-earning structure, and expenditure in the 'acquisition, expansion or improvement' of those assets is thus of a capital nature.<sup>295</sup> Generally, such expenditure of a capital nature will not be deductible from income,<sup>296</sup> and thus the Taxpayer will be greatly benefited if he can obtain the benefits of the First Schedule in this regard. In particular, the Taxpayer may seek to apply the provisions of paragraph 12(1)(f) of that Schedule to expenditure incurred by him on the erection of, or extensions, additions or improvements (other than repairs) to such buildings.<sup>297</sup>

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<sup>293</sup> Section 26(1).

<sup>294</sup> Chapters 2 and 3 above.

<sup>295</sup> *New State Areas Ltd v CIR* 1946 AD 610; 14 SATC 155 at 163 – 164. The said assets clearly constitute part of the Taxpayer's 'means of production, i.e. the property plant, tools, etc., which he uses in the performance of his income-earning operations.'

<sup>296</sup> Section 11(a) read with section 23(g); Refer also to *Stretch and Silke* (note 71 above).

<sup>297</sup> 2.3.3 above.



The effect of paragraph 12(1)(f) will be that the Taxpayer should be entitled to a 100% deduction of the abovementioned types of expenditure incurred by him, but limited to his taxable income from farming operations. It is submitted that the abovementioned buildings are likely to be of a substantial cost to farmers such as the Taxpayer, and therefore the prospect of the said deduction should be highly advantageous from his point of view. However, it should be noted that certain recent amendments to the Act will have the effect that the Taxpayer will no longer be able to deduct such expenses in respect of buildings used for the housing of his employees.<sup>298</sup> In spite of this setback, though, it is notable that there is still no provision in the Act which provides, in respect of buildings used in a 'process of manufacture,' for a concession as beneficial as that contained in paragraph 12(1)(f).<sup>299</sup> The latter point alone may be persuasive grounds for persons such as the Taxpayer to argue for the inclusion of his 'process of manufacture' within the ambit of his / her 'farming operations.' The various further details of the interpretation and application of paragraph 12(1)(f) have been discussed in 2.3.3 above.

The second most relevant concession applicable to the winemaking process of the Taxpayer, is that contained in section 12B(1)(f). Briefly, as discussed in 2.3.2 above, this concession allows a phased deduction over three years (i.e. 50% in year one, 30% in year two and 20% in year three) of the cost of any machinery, implement, utensil or article (other than livestock) 'brought into use for the first time by (the) taxpayer and used by him or her in the carrying on of his or her farming operations.'<sup>300</sup> Based on the argument above, the Taxpayer may thus seek to apply this concession to the specialised equipment (e.g. pumps, tanks and barrels) used by him in his winemaking process.

Similarly to paragraph 12B(1)(f), this very favourable concession does not have an equally beneficial counterpart that deals with similar equipment used in a 'process of manufacture.' While section 12C does provide for an accelerated depreciation allowance in respect of 'machinery or plant' owned or acquired by a taxpayer for use by him or by his lessee in a 'process of manufacture', this allowance is spread over four or five years

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<sup>298</sup> Section 57 of the Revenue Laws Amendment Act No. 60 of 2008; 2.3.3 above.

<sup>299</sup> The most similar concession to that contained in paragraph 12(1)(f), but applicable to manufacturing processes, is the annual allowance provided for in section 13; although this concession is not nearly as beneficial or extensive as that contained in paragraph 12(1)(f) (3.3 above).

<sup>300</sup> Section 12B(1)(f).

(depending on date of acquisition), and is thus not quite as favourable as the allowance under section 12B(1)(f), which applies specifically to farming operations.<sup>301</sup>

The abovementioned tax concessions may be of most potential benefit to the Taxpayer in respect of his winemaking process, but there may be other concessions which can have favourable tax consequences in his case (the most relevant of which were referred to in 2.3 above). It should be noted, finally, that the application of any concessions on the strength of an argument such as that formulated in 6.3 above, is highly dependent on the facts and circumstances of the particular taxpayer.

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<sup>301</sup> The finer points of the interpretation and application of section 12C are discussed in 3.2 above.

## **7. CONCLUDING REMARKS**

This study sought to argue, firstly, that taxpayers who earn income from carrying on farming operations have access to more favourable tax concessions than those who earn income from processes of manufacture (chapters 2 – 3 above). The most relevant concessions applicable to these respective industries or trades were discussed, and those of lesser significance were referred to.

In chapter 4, a question foundational to the main focus of this study was discussed, namely: ‘Where do ‘farming operations’ end and other trades or activities begin?’ In the context of the available jurisprudence, this question was phrased more specifically as: ‘Is it possible for activities which may not, in ordinary parlance, constitute ‘farming operations’, to be included within the ambit of that phrase, and if so, under what circumstances?’ It was shown, with reference to judicial commentaries and the literature, that the latter, more specific question has been the subject of some consideration. The conclusion, based on the aforementioned authority, was that certain so-called ‘post-farming’ activities may indeed be included within the phrase ‘farming operations.’ Certain general guidelines were identified, the relevance of which was emphasised with reference to judicial application in subsequent cases.

Ultimately, chapter 5 introduced the main aim of this study, namely to discuss the occurrence of taxpayers who carry on ‘farming operations’ and ‘processes of manufacture’ simultaneously. The relevance of this particular focus was explained in light of the modern trend toward such a convergence of activities, followed by a discussion of relevant case law, applicable commentaries and fiscal legislation. The relevant guidelines already referred to were applied, and further guidelines on this specific focus area were introduced.

Chapter 6, in conclusion, sought to illustrate the possible application of the relevant guidelines. In particular, this chapter argued that favourable tax planning opportunities may arise for taxpayers who carry on the distinct trades of farming and manufacturing simultaneously. A hypothetical scenario was accordingly set out and a suggested argument formulated in the context of the postulated facts, with the aid of the relevant principles and guidelines. Thereafter, on the supposition that such argument would be successful, a brief discussion followed which sought to highlight the most relevant concessions which the postulated taxpayer could expect.

In conclusion it is submitted that the guidelines referred to in this study (whilst not purporting to be exhaustive) may be fruitfully applied, for tax planning purposes, by taxpayers who carry on farming operations and manufacturing processes simultaneously. However, it should be emphasised that the taxpayer's particular factual circumstances and all relevant factors should be closely considered, in light of the said guidelines.

While the formulation of an exhaustive list of principles applicable to all scenarios is not considered viable, this study discussed some of the relevant issues, principles and opportunities which may be of assistance to taxpayers such as those considered herein.

**(23,650 words, excluding footnotes)**

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